

TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1901.

No. 609.

CONTINENTAL INSURANCE COMPANY AND FIDELITY-
PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
APPELLANTS,

vs.

THE UNITED STATES OF AMERICA, READING COMPANY,
THE PHILADELPHIA AND READING COAL & IRON
COMPANY, ET AL.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCKNER, AND JOHN
H. MASON, AS A COMMITTEE REPRESENTING HOLD-
ERS OF COMMON STOCK OF THE READING COMPANY,
APPELLANTS,

vs.

THE UNITED STATES OF AMERICA, READING COMPANY,
PHILADELPHIA AND READING COAL & IRON COM-
PANY, ET AL.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

FILED NOVEMBER 2, 1901.

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(28,565)

IN THE
SUPREME COURT OF THE UNITED STATES

No. . OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY
AND
FIDELITY-PHENIX FIRE INSURANCE COMPANY
OF NEW YORK,

APPELLANTS,

VS.

READING COMPANY, ET AL.,
APPELLEES.

SEWARD PROSSER, MORTIMER N. BUCKNER
AND JOHN H. MASON AS A COMMITTEE, ETC.,
APPELLANTS,

VS.

READING COMPANY, ET AL.,
APPELLEES.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES, EASTERN
DISTRICT OF PENNSYLVANIA.

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**Docket entries in the United States District Court for the Eastern
District of Pennsylvania.**

No. 10-95. September sessions, 1913. In Equity. No. 1095.

THE UNITED STATES OF AMERICA

VS.

**READING COMPANY, PHILADELPHIA &
READING RAILWAY COMPANY, THE
PHILADELPHIA & READING COAL &
IRON COMPANY, THE LEHIGH &
WILKES-BARRE COAL COMPANY, THE
LEHIGH COAL & NAVIGATION COM-
PANY, corporations of Pennsylvania;
THE CENTRAL RAILROAD COMPANY OF
NEW JERSEY, a corporation of New
Jersey; WILMINGTON & NORTHERN
RAILROAD COMPANY, a corporation of
Pennsylvania and Delaware; LEHIGH
& HUDSON RIVER RAILWAY COMPANY,
a corporation of New York and New
Jersey; LEHIGH & NEW ENGLAND
RAILROAD COMPANY, a corporation of
Pennsylvania and New Jersey;
GEORGE F. BAER, GEORGE F. BAKER,
EDWARD T. STOTESBURY, HENRY C.
FRICK, PETER A. B. WIDENER, HENRY
A. DU PONT, DANIEL WILLARD, HENRY
P. MCKEAN, and SAMUEL DICKSON.**

1913.

Sept. 2. Petition filed.

**" 3. Petition for and order directing service of
subpœnas on nonresident defendants filed.**

***Præcipe* for subpœna filed.**

**Original subpœna for Eastern District of Penn-
sylvania issued.**

1913.

- Sept. 3. Duplicate subpoena for Southern District of New York issued.

Duplicate subpoena for Western District of Pennsylvania issued.

- " 4. Duplicate subpoena for District of Maryland issued.

Duplicate subpoena for District of Delaware issued.

- " 10. Duplicate subpoena for Southern District of New York returned "Served on Central Railroad Company of New Jersey, Lehigh & Hudson River Railway Company, and George F. Baker, together with copy of original petition and order," and filed.

Duplicate subpoena to District of Delaware returned "Served on Henry A. du Pont together with copy of petition and order" and filed.

- " 11. Duplicate subpoena to Western District of Pennsylvania returned "Served on Henry C. Frick with copies of petition and order" and filed.

Duplicate subpoena of District of Maryland returned "Served with copy of petition and order on Daniel Willard" and filed.

- " 19. Order for the appearance of William Jay Turner, Esquire, for Lehigh & New England Railroad Company, one of defendants, filed.

- " 24. Order for the appearance of Charles Heebner, Esquire, for Reading Company, Philadelphia & Reading Railway Company, Philadelphia & Reading Coal & Iron Company, Wilmington & Northern Railroad Company, George F. Baer, George F. Baker, Edward T. Stotesbury, Henry C. Frick, Peter A. B. Widener, Henry A. du Pont, Daniel Willard, Henry P. McKean, and Samuel Dickson filed.

1913.

- Sept. 29. Original subpoena returned "Served on Sept. 4, 1913, on Reading Company, Philadelphia & Reading Rwy. Company, Lehigh & Wilkes-Barre Coal Company, Lehigh Coal & Navigation Company, Wilmington & Northern Railroad Company, and Lehigh & New England Railroad Company, and Henry P. McKean (answer due Sept. 24, 1913), and on Peter A. B. Widener on Sept. 8 (answer due Sept. 28, 1912), and on Sept. 11, 1913, on George F. Baer and Samuel Dickson and Edward T. Stotesbury (answer due Oct. 1, 1913)," and filed.
- Oct. 18. Answer of Lehigh Coal & Navigation Company filed.
- " 21. Answer of Lehigh & New England Railroad Company filed.
- " 22. Answer of Wilmington & Northern Railroad Company filed.
- Answer of Reading Company filed.
- Answer of Philadelphia & Reading Coal and Iron Company filed.
- Answer of Philadelphia & Reading Railway Company filed.
- " 25. Order for the appearance of Robert W. deForest, Esq., and Jackson E. Reynolds, Esq., for Central Railroad Company of New Jersey filed.
- Order for the appearance of Robert W. deForest, Esq., and Jackson E. Reynolds, Esq., for Lehigh & Wilkesbarre Coal Company filed.
- " 29. Joint and separate answer of George F. Baer, George F. Baker, Edward T. Stotesbury, Henry C. Frick, Peter A. B. Widener, Henry A. du Pont, Daniel Willard, Henry P. McKean, and Samuel Dickson filed.

VIII

1913.

Nov. 1. Answer of Lehigh & Hudson River Railway Company filed.

" 13. Answer of Lehigh & Wilkesbarre Coal Company filed.

Answer of Central Railroad Company of New Jersey filed.

1914.

Jany. 27. Order appointing examiner and fixing times for testimony filed.

Mch. 26. Expediting certificate of attorney general filed.

May 23. Typewritten testimony (6 volumes) filed.

Petitioner's printed evidence and exhibits Vol. 1, filed.

Defendant's printed copy evidence & exhibits filed.

Petitioner's printed copy evidence and exhibits in rebuttal filed.

Book of maps produced before examiner filed.

" 28. Petitioner's Exhibit No. 1 (map) filed.

June 3. Petitioner's exhibit 19th annual report of Board of Directors of Lehigh & New England Railroad Company, 93rd annual report of Lehigh Coal & Navigation Company; report of June 30, 1913, of Central Railroad Company of New Jersey; report of June 30, 1913, of Lehigh & Wilkesbarre Coal Company; 31st annual report of Lehigh & Hudson River Railway Company; plan and agreement for the reorganization of Philadelphia & Reading Railroad Company, and Philadelphia & Reading Coal & Iron Company of Dec. 14, 1895 filed.

" 3. Argued *sur* pleadings and proofs.

" 4. Argued *sur* pleadings and proofs.

IX

1914.

- June 22. Petitioner's Exhibit No. 4, plan and agreement for reorganization of Philadelphia & R. Co., and Phila. & Reading Coal & Iron Co., dated December 14, 1895, filed.

Reply brief of petitioner filed.

Supplemental memorandum of Reading Company, Philadelphia & Reading Rwy. Co., and Phila. & Reading Coal & Iron Company filed.

1915.

- July 3. Opinion, McPherson, J., granting decree for defendants, filed.

Sept. 30. Argued *re* settlement of decree.

Oct. 28. Final decree filed.

- Nov. 17. Assignments of error on behalf of the United States filed.

Petition of the United States for appeal filed.

Order allowing petition of United States for appeal filed.

Petition as to transcript of record *sur* appeal filed.

Order directing reproduction of testimony in transcript of record *sur* appeal filed.

- " 22. Stipulation for filing *nunc pro tunc* of copy of annual report of Reading Company for year ended June 30, 1913, filed.

Sixteenth annual report of Reading Company filed *nunc pro tunc* in accordance with stipulation filed November 22, 1915.

Stipulation for transcript of record *sur* appeal filed.

Citation returned "Service accepted" and filed.

1920.

- Aug. 13. Mandate from Supreme Court of United States affirming in part and reversing in part decree of this court and remanding cause to this court with direction to enter decree received and filed.
- Oct. 8. Interlocutory decree filed.
Decree authorizing Reading Company to secure proxies for certain stock filed.
- Dec. 31. Motion for extension of time for filing plan of dissolution filed.
Decree fixing time for hearing *sur* motion for extension of time for filing plan of dissolution filed.

1921.

- Jan. 5. Petition of William B. Kurtz and M. F. Kurtz for leave to intervene filed.
- Feb. 14. Proposed plan of Reading Company, Philadelphia & Reading Rwy. Company and Philadelphia & Reading Coal & Iron Company, filed.
Counter proposal of plaintiff to paragraph of proposed plan of Philadelphia & Reading Railway Company and Philadelphia & Reading Coal & Iron Company, filed.
Memorandum of plaintiff *in re* proposed plan of dissolution filed.
Proposed plan for disposal by Central Railroad Company of N. J. of stock owned or controlled by Lehigh & Wilkes Barre Coal Company, filed.
Decree modifying injunction heretofore issued so as to permit Central Railroad Company of New Jersey to receive certain dividends upon the stock of Lehigh & Wilkes Barre Coal Company, filed.
Decree as to disposition of copies of plan, etc., and fixing time for further hearing *in re* plan for dissolution filed.

1921.

Mch. 1. Hearing *sur* plan of Reading Company and proposed intervention.

" 19. Affidavit as to service of copy of Reading Plan, etc., filed.

Apr. 7. Certificate of Victor B. Woolley, U. S. Circuit Judge, as to his disqualification to sit in this case filed.

Designation of J. Whitaker Thompson, U. S. District Judge, to sit at hearings in this case filed.

" 12. Notice of motion for leave to file supplemental bill of complaint filed, *nunc pro tunc* as of March 1, 1921.

Motion for leave to file supplemental bill of complaint filed *nunc pro tunc* as of March 1, 1921.

Draft of Supplemental bill of complaint filed *nunc pro tunc* as of March 1, 1921.

Petition of Reading Company for reasonable time within which to file answers to petitions for leave to intervene filed, *nunc pro tunc* as of March 12, 1921.

Petition of Frances T. Ingraham for information from Reading Company as to the value of her interest in the Reading property filed *nunc pro tunc* as of March 15, 1921.

Petition of Baltimore & Ohio Railroad Company for leave to intervene filed *nunc pro tunc* as of March 15, 1921.

Petition of Girard Ave. Title & Trust Company to intervene filed *nunc pro tunc* as of March 15, 1921.

Petition of Adrian Iselin *et al.* for leave to intervene filed *nunc pro tunc* as of March 15, 1921.

Petition of Penn Mutual Life Insurance Company for leave to intervene filed *nunc pro tunc* as of March 15, 1921.

1921.

- Apr. 12. Petition of the New York Central Railroad Company for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Amended petition of the New York Central Railroad Company for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Petition of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Petition of Frances T. Ingraham *et al.* for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Printed copy of petition of Frances T. Ingraham for information from the Reading Company as to the value of her interest in the Reading property filed *nunc pro tunc* as of March 15, 1921.
- Petition of the Pennsylvania Company for Insurances on Lives & Granting Annuities *et al.* for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Petition of Seward Prosser *et al.*, Committee for Common stockholders for leave to intervene filed *nunc pro tunc* as of March 15, 1921.
- Petition of Joseph E. Widener for leave to intervene and to file a separate answer to certain intervening petitions and cross-petitions filed *nunc pro tunc* as of March 15, 1921.
- Amended and supplemental petition for modification of plan of dissolution of Seward Prosser, *et al.* filed *nunc pro tunc* as of March 15, 1921.
- Answer of Reading Company to intervening petitions and cross petitions to said petitions filed *nunc pro tunc* as of April 5, 1921.

- 1921.
- Apr. 12. Decree granting leave to foregoing petitioners to intervene and directing that Central Union Trust Co. of New York, Trustee, be made party defendant, filed.
- Answer of Central Union Trust Company of New York, Trustee, filed.
- Decree fixing time of hearing argument on certain questions, etc., filed.
- " 15. Appearance of George S. Ingraham, Esq., for Frances T. Ingraham Robert S. Ingraham, Mabel B. Ingraham, George S. Ingraham and Marcus L. Taft, filed.
- " 16. Appearance of Alexander S. Lyman for New York Central Railroad Company filed.
- Certificate of ownership of certain stock by Girard Ave. Title & Trust Company filed.
- " 18. Certificate as to stock ownership of Wm. B. Kurtz filed.
- Appearance of Thomas Raeburn White for Wm. B. Kurtz filed.
- Appearance of T. R. White for Madge Fulton Kurtz filed.
- Appearance of M. J. Ryan for the Girard Ave. Title & Trust Co. filed.
- Appearance of George Wharton Pepper, Esq., for Penn Mutual Life Ins. Co. filed.
- Certificate as to stock ownership of Madge Fulton Kurtz filed.
- " 20. Certificate as to stock ownership of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York and of their appearance filed.
- " 22. Notice of intervention as parties defendant of Seward Prosser, *et al.*, Committee for Common stockholders and their appearance as such intervening defendant parties defendant filed.

1921.

- Apr. 22. Certified copies of proxies of certain common stockholders filed.
- “ 26. Appearance of Ellis Ames Ballard for Joseph E. Widener filed.
Appearance of Larkin, Rathbone & Perry for Central Union Trust Company of New York filed.
- “ 27. Certificate as to stock ownership of Estate of P. A. B. Widener, and Joseph E. Widener filed.
Appearance of H. B. Gill for Baltimore & Ohio Railroad Company, filed.
- “ 28. Memorandum on behalf of Central Union Trust Company of New York, Trustee under General Mortgage of Reading Company, *et al.*, filed.
- May 2. Hearing *sur* settlement of decree (Modification of plan to be filed in ten days).
- “ 12. Modification of Reading plan filed.
- “ 21. Opinion, Buffington, *J.*, directing decree to be submitted to the Court making effective Mandate from U. S. Supreme Court in accordance with modified plan agreed to by Reading Company and Attorney General of United States filed.
- June 6. Final Decree filed.
- “ 11. Decree appointing Trustees filed.
- “ 16. Hearing *in re* petition of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York for appeal.
Petition of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company for appeal filed.
Assignments of error filed.
Decree granting petition for appeal filed.

- 1921.
- July 20. Bond *sur* appeal in \$750,000 with United States Fidelity & Guaranty Company, filed. Order of Court approving bond *sur* appeal filed.
- " 21. Citation allowed and issued.
- " 22. Appearance of Wm. Clarke Mason, Esq., and R. C. Leffingwell, Esq., for Reading Company, filed.
- Aug. 3. Petition for appeal by Seward Prosser, *et al.*, Committee for Common stockholders, filed. Decree granting prayer of petition filed. Assignments of Error filed.
- " 5. Sum of \$2,500 deposited in Registry of the Court in lieu of bond *sur* appeal by Seward Prosser, *et al.*, Committee for Common stockholders. Citation allowed and issued.
- " 8. Citation by Continental Insurance Company, *et al.*, returned, service accepted and filed.
- " 26. Citation by Seward Prosser, *et al.*, returned—service accepted—and filed.
-



UNITED STATES *v.* READING COMPANY ET AL.
READING COMPANY ET AL. *v.* UNITED STATES.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Nos. 3, 4. Argued October 10, 11, 1916; restored to docket
for reargument May 21, 1917; reargued November
20, 21, 1917; restored to docket for reargument
June 10, 1918; reargued October 7, 1919.—Decided
April 26, 1920.

THE SOLICITOR GENERAL, with whom THE ATTORNEY
GENERAL and MR. A. F. MYERS were on the brief,
for the United States.¹

MR. JACKSON E. REYNOLDS, with whom MR. CHARLES
HEEBNER and MR. JOHN G. JOHNSON were on the
brief, for Reading Company, Philadelphia &
Reading Railway Company, and the Philadelphia
& Reading Coal & Iron Company.²

MR. ROBERT W. DE FOREST, with whom MR. CHARLES
E. MILLER was on the brief, for Central Railroad
Company of New Jersey.

MR. HENRY S. DRINKER, JR., and MR. ABRAHAM M.
BEITLER filed a brief on behalf of the Lehigh
Coal & Navigation Company.

MR. JOHN J. BEATTIE filed a brief on behalf of the
Lehigh & Hudson River Railway Company.

MR. WM. JAY TURNER filed a brief on behalf of the
Lehigh & New England Railroad Company.

¹ At the first and second hearings the case was argued by *Mr. Solicitor General Davis* and *Mr. Assistant to the Attorney General Todd*. *Mr. Attorney General Gregory* and *Mr. Thurlow M. Gordon*, Special Assistant to the Attorney General, also were on the brief.

² At the first hearing *Mr. John G. Johnson* argued the case for the Philadelphia & Reading Coal & Iron Company.

MR. JUSTICE CLARKE delivered the opinion of the court.

These are appeals from a decree entered in a suit instituted by the Government to dissolve the intercorporate relations existing between the corporation defendants, for the alleged reason that through such relations they constitute a combination in restraint of interstate commerce in anthracite coal, and an attempt to monopolize or a monopolization of such trade and commerce in violation of the first and second sections of the Anti-Trust Act of Congress, of July 2, 1890, c. 647, 26 Stat. 209; and also for the alleged reason that the defendants, Philadelphia & Reading Railway Company and Central Railroad Company of New Jersey are violating the commodities clause of the Act of Congress of June 29, 1906, c. 3591, 34 Stat. 585, by transporting over their lines of railroad, in interstate commerce, coal mined or purchased by coal companies with which they are associated by stock ownership.

It will contribute to brevity and clearness to designate the defendant corporations as follows: Reading Company, as the Holding Company; Philadelphia & Reading Railway Company, as Reading Railway Company; Philadelphia & Reading Coal & Iron Company, as Reading Coal Company; Central Railroad Company of New Jersey, as Central Railroad Company; Lehigh & Wilkes-Barre Coal Company, as Wilkes-Barre Company; Lehigh Coal & Navigation Company, as Navigation Company.

Practically all of the anthracite coal in this country is found in northeastern Pennsylvania, in three limited and substantially parallel deposits, located in valleys which are separated by mountainous country. For trade purposes these coal areas are designated: the most northerly, as the Wyoming field, estimated to contain about 176 square miles of coal; the next southerly, as the Middle or Lehigh field, estimated to contain about 45 square miles, and the most southerly, as the Schuylkill field, estimated to contain about 263 square miles of coal.

The annual production of the mines in these three fields in 1896 was about 43,640,000 tons and in 1913 it slightly exceeded 71,000,000 tons. The chief marketing centers for this great tonnage of coal are New York, distant by rail from the fields about 140 miles, and Philadelphia, distant about 90 miles. From these cities it is widely distributed by rail and water throughout New York and New England, and to some extent, through the South.

Such a large tonnage was naturally attractive to railroad carriers, with the result that the Wyoming field has six outlets by rail to New York Harbor, viz: The Central Railroad of New Jersey and five others, known as initial anthracite carriers. The Lehigh field has three such rail outlets, but the largest, the Schuylkill field, has only two direct rail connections with Philadelphia and New York, viz: The Reading and the Pennsylvania Railroads. Outlets by canal to Philadelphia and tidewater, at one time important, may here be neglected.

This description of the subject-matter and of its relation to the interstate transportation system of the country will suffice for the purposes of this opinion. It may be found in much greater detail in the cases cited in the margin.¹

The essential claims of the Government in the case have become narrowed to these, viz:

FIRST: That the ownership by the Holding Company of controlling interests in the shares of the capital stocks of the Reading *Railway* Company, of the Reading Coal Company and of the Central Railroad Company, constitutes a combination in restraint of interstate trade and commerce and an attempt to monopolize and a monopolization of a part of the same in violation of the Anti-Trust Act of July 2, 1890.

¹ *United States v. Reading Co.*, 183 Fed. Rep. 427; *United States v. Reading Co.*, 226 Fed. Rep. 229; *United States v. Delaware & Hudson Co.*, 213 U. S. 366; *United States v. Lehigh Valley R. R. Co.*, 220 U. S. 257; *United States v. Delaware, Lackawanna & Western R. R. Co.*, 238 U. S. 516; *United States v. Reading Co.*, 226 U. S. 324.

SECOND: That the Holding Company in itself constitutes a like violation of the act.

THIRD: That certain covenants and agreements between the Central Railroad Company and the Navigation Company contained in a lease, by the latter to the former, of the Lehigh & Susquehanna Railroad, constitute a like violation of the act.

FOURTH: That the transportation in interstate commerce by the Reading Railway Company and by the Central Railroad Company, of coal mined or purchased by the coal companies affiliated with each of them constitutes a violation of the commodities clause of the Act to Regulate Commerce.

Pursuant to the provisions of the Act of June 25, 1910, c, 428, 36 Stat. 854, the case was heard by three Circuit Judges of the Third Circuit, who while holding against the contention of the Government on many of the prayers for relief in the bill, some generally and some without prejudice, also held that the Reading Coal Company and the Wilkes-Barre Coal Company were naturally competitive producers and sellers of anthracite coal and that their union through the Holding Company and the Central Company constituted a combination in restraint of trade within the Anti-Trust Act, and for this reason the Central Company was ordered to dispose of all the stock, bonds and other securities of the Wilkes-Barre Coal Company owned by it and was enjoined from requiring the Coal Company to ship its coal over the lines of the Central Company.

The court also held that clauses in mining leases by the Reading Coal Company and by the Wilkes-Barre Coal Company, and their subsidiaries, requiring the lessees to ship all coal produced, over roads, named or to be designated, were unlawful and void.

The case has been appealed by both parties and is before us for review on all of the issues as we have thus stated them.

Reference to the history of the properties now controlled by the Holding Company will be of value for the assistance it will be in determining the intent and purpose with which the combinations here assailed were formed. *Standard Oil Co. v. United States*, 221 U. S. 1, 46, 76.

The Philadelphia & Reading Railroad Company was chartered by special act of the Pennsylvania General Assembly in 1833, and it conducted the business of a railroad carrier prosperously for about thirty years, when, as its annual reports show, it embarked upon the policy of attempting to control the anthracite tonnage of the Schuylkill field by acquiring extensive ownership of coal lands. Thus, the report of the Company for 1871 contains the following:

"Up to this time about 70,000 acres of the best anthracite coal lands in Pennsylvania have been acquired and will be held by an auxiliary company, known as the Philadelphia and Reading Coal and Iron Company, of which the Philadelphia and Reading Railroad Company is the only stockholder. The result of this action has been to secure—and attach to the company's railroad—a body of coal land capable of supplying all the coal-tonnage that can possibly be transported over the road for centuries."

And this is from the report for 1880:

"The transportation of coal has always been a source of great profit to the railroad company, and the only doubt in the past about the permanency of the earning power of the company as a transporter was due to the fear that rival companies would tap the Schuylkill region, and divert the coal tonnage to their own lines. This danger was happily averted by the purchase of the coal lands."

And this from the report of 1881 :

"The coal estates of the Philadelphia and Reading Company . . . consist of 91,149 acres (142 square miles) of coal lands, which is sixty per cent of all the anthracite lands in the Schuylkill district, and thirty per cent of all in Pennsylvania."

This area of coal lands had increased by 1891 to 102,573 acres, of which the report said :

"The coal lands comprise in extent about 33 per cent of the entire anthracite coal fields of the State, and taking into account the aggregate thickness of the veins on the company's lands, and the greater proportionate depletion of the estates in the other regions which has been going on for many years, it must be conceded that we have at least 50 per cent of the entire deposit remaining unmined."

As if in further pursuit of this now settled purpose, in the following year, 1892, the Reading Railroad Company leased the Lehigh Valley Railroad and the Central Railroad of New Jersey for 999 years. These were both anthracite carriers, competing with the Reading and each had an important coal mining subsidiary company. But the lease by the Central Railroad Company was assailed in the New Jersey courts and all operations under it were enjoined, with the result that both leases were abandoned.

It is obvious that these reports show an avowed and consistently pursued purpose (not then prohibited by statute) to secure by purchase a dominating control over the coal of the Schuylkill field and over the transportation of it to market.

In the large financial operations incident to the expansion policy thus described, bonds were issued, secured by a mortgage on all of the property of the Reading Railroad Company and of the Reading Coal Company. In 1893 there was default in the payment of interest on these bonds and receivers were appointed who operated both

properties until 1896 when they were sold to representatives of the creditors and stockholders of the two companies, and under a scheme of reorganization, the validity of which is assailed in this suit, both properties were transferred to three corporations in the manner now to be described:

1st. To the Reading *Railway* Company, a corporation newly organized under the laws of Pennsylvania, were allotted about 1,000 miles of the railroad (but none of the equipment) which had been owned or leased by the former Reading *Railroad* Company. The capital stock of this company was fixed at \$20,000,000 and it issued \$20,000,000 of bonds, all of which were given to the Holding Company. The property thus transferred was valued, in the representations made at the time to the New York Stock Exchange, at \$90,000,000. In 1896 this railroad carried in excess of 9,000,000 tons of anthracite,—more than one-fifth of the then total production of the country. But by the plan of reorganization adopted it was disabled from performing its functions as a carrier, except with the aid of the Holding Company, for all of the equipment, engines, cars and ships, owned by the former Railroad Company, and its tidewater terminals at Philadelphia and on New York Harbor, were allotted to the Holding Company.

2nd. By the decree of sale the Reading Coal and Iron Company was released from its former obligations and to it thus freed the principal part of the property (coal and other), owned by it before the sale, was allotted and re-transferred upon condition, that it would deliver all of its capital stock to the Holding Company, would become co-obligor with that company on bonds to be issued, and would join with it in executing a mortgage for \$135,000,000 on all of its property to secure such bonds. This Company thus came into possession of 102,573 acres

of anthracite lands, owned and leased,—almost two-thirds of the entire acreage of the Schuylkill coal field,—stocks and bonds in other coal companies, coal in storage and other property, all of the estimated value of \$95,000,000.

3rd. To serve the purposes of the intended Holding Company, a charter granted in 1871 by special act of the General Assembly of Pennsylvania, but unused for twenty years, was utilized. This charter was of the class denominated "omnibus" by the Supreme Court of Pennsylvania, and in terms it authorized the company to engage in, or control, almost any business other than that of a bank of issue,—this broad charter was the occasion for making use of the company in this enterprise. The corporate name was changed to "Reading Company," its capital stock was increased from \$100,000 to \$140,000,000, and the purchasers at the receivers' sale allotted and transferred to it railroad equipment, real estate, colliers and barges, formerly owned by the Reading *Railroad* Company, together with stocks which gave it control of more than thirty short line railroads, aggregating 275 miles of track, and other property of large value, in addition to all of the bonds and stock of the new Reading *Railway* Company and all of the stock of the Reading Coal Company.

The result of this intercorporate transfer of the property, owned before the reorganization by the Reading *Railroad* Company and the Reading Coal and Iron Company, was that the Holding Company without any outlay—solely because the creditors and stockholders of the former Reading *Railroad* Company and of the Reading Coal Company desired to establish the proposed scheme for control of the properties formerly owned by the two companies—became the owner of the title to railway equipment, real estate, colliers and barges of an estimated value of \$34,400,000; plus all of the capital

stock and bonds of the New Railway Company, \$40,000,000; plus all of the capital stock of the Coal Company, \$8,000,000, and a contract by that company to mortgage, for the use of the Holding Company, its entire property; plus other stocks, bonds and mortgages owned by the former Railroad Company of the estimated value of over \$38,000,000,—making a total value, as represented at the time to the New York Stock Exchange, of \$193,613,000.

Thus, this scheme of reorganization, adopted and executed six years after the enactment of the Anti-Trust Act, combined and delivered into the complete control of the board of directors of the Holding Company all of the property of much the largest single coal company operating in the Schuylkill anthracite field, and almost one thousand miles of railway over which its coal must find its access to interstate markets. This board of directors, obviously, thus acquired power: to increase or decrease the output of coal from very extensive mines, the supply of it in the market, and the cost of it to the consumer; to increase or lower the charge for transporting such coal to market; and to regulate car supply and other shipping conveniences, and thereby to help or hinder the operations of independent miners and shippers of coal. This constituted a combination to unduly restrain interstate commerce within the meaning of the act. *United States v. Union Pacific R. R. Co.*, 226 U. S. 61.

Obviously, also, it made the Coal Company and the Railway Company mere agents or instrumentalities of the Holding Company—the mining and transportation departments of its business—for producing, purchasing, and selling coal and for transporting it to market. The Reading Railway Company and the Reading Coal Company each had thereafter but one stockholder,—the Holding Company—and their earnings were to be distributed not in proportion to the shares of their capital stocks, aggregating \$28,000,000, but were to go to the creditors

and shareholders of the Holding Company, with its mortgage debt of \$135,000,000 and its capital stock of \$140,000,000. The Holding Company thus served to pool the property, the activities and the profits of the three companies. *Northern Securities Co. v. United States*, 193 U. S. 197, 327, 362.

It will be profitable to consider next what use was made of the great power thus gathered into the one Holding Company.

In 1898 this Holding Company entered into a combination with five other anthracite carrying railroad companies to prevent the then contemplated construction of an additional line of railway from the Wyoming field to tide-water, which independent miners and shippers of coal were promoting for the purpose of securing better rates on their coal to the seaboard. In a mere holding company, the Temple Iron Company, all six carriers combined, as stockholders for the purpose of providing \$5,000,000 with which the properties of the chief independent operators, Simpson and Watkins, were purchased and thereby the new railroad project was defeated. The president of the Holding Company was active in the enterprise and that company, although only one of six, became responsible for thirty per cent. of the required financing. In *United States v. Reading Co.*, 226 U. S. 324, 351, this court characterized what was done by this combination, under the leadership of the Holding Company, in these terms:

"The New York, Wyoming & Western Railroad Company was successfully strangled, and the monopoly of transportation collectively held by the six defendant carrier companies was maintained."

And, again, at p. 355:

"We are in entire accord with the view of the court below in holding that the transaction involved a concerted scheme and combination for the purpose of restraining commerce among the States in plain violation of the Act of Congress of July 2, 1890."

About the year 1900 the Holding Company and many other initial anthracite carriers and their controlled coal companies, pursuant to an agreement with each other, made separate agreements with nearly all of the independent producers of coal along their lines, to purchase at the mines "all the anthracite coal thereafter mined from any of their mines now opened or operated or which might thereafter be opened and operated," and to pay therefor 65% of the average price of coal prevailing at tidewater points at or near New York, computed from month to month. In the case above cited, this court discussed these contracts and declared: that they were made for the purpose of eliminating the competition of independent operators from the markets and thus removing "a menace to the monopoly of transportation to tidewater which the defendants collectively possessed"; that before these contracts, there existed not only the power to compete but actual competition between the coal of the independents and that produced by the buying defendants, but that after the contracts were made "such competition was impracticable"; that the case fell well within not only the *Standard Oil and Tobacco Cases*, 221 U. S. 1, 106, but was of such an unreasonable character as to be "within the authority of a long line of cases decided by this court;" and finally that the defendants had combined, by and through the instrumentality of the 65% contracts with the purpose and design of unlawfully controlling the sale of the independent output of coal at tidewater.

Thus, this court held that once within two years and again within four years after it was organized, this Holding Company used the great power which we have seen was centered in its board of directors, by adroit division of property and of corporate agency, for the purpose of violating, in a flagrant manner, the Anti-Trust Act of 1890.

Almost immediately after the two attempts to monopolize the trade in anthracite thus condemned by this

court, the Holding Company, in January, 1901, purchased a controlling interest in the capital stock of the Central Railroad Company. When this suit was commenced that company was operating 675 miles of track, over which it carried in 1913, 10,783,000 tons of anthracite,—almost one-half of its total freight traffic. Its capital stock was then \$27,436,000 and its funded debt was \$46,881,000.

This Central Company owned, at the time, in excess of eleven-twelfths of the capital stock of the Wilkes-Barre Coal Company, with a capital stock of over \$9,000,000 and a funded debt of about \$17,000,000. And that company owned or had leased in excess of 14,000 acres of coal bearing lands—13,000 acres in the Wyoming field—and in the year ending June 30, 1913, it shipped from its lands thus owned or controlled, 6,243,000 tons of coal, which was sold for over \$20,000,000.

Immediately after this purchase, the president of the Holding Company, Mr. Baer, was made president of the Central Railroad Company and of the Wilkes-Barre Coal Company, and remained such until his death, after the commencement of this suit, and from one-third to one-half of the directors of each company were thereafter chosen from the board of the Holding Company. Thus from the time of this purchase both companies have been actively dominated by the Holding Company management.

It is argued that the Central Railroad, thus acquired, and the Reading system were not competitors, but this question is put beyond discussion by the testimony of Mr. Baer, the president of the Reading Company, and his immediate predecessor in office, Mr. Harris. The former testified:

“Q. You are president of the defendants, the Reading Company, Philadelphia and Reading Railway Company, Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey, the Lehigh and Wilkes-Barre Coal Company and the Temple Iron Company?

"A. I am. . . ."

"Q. What do you regard as the competitors of the Philadelphia and Reading now in New York Harbor, as to anthracite coal? . . ."

"A. All the companies that ship to New York. They would be the Pennsylvania Railroad, the Lehigh Valley, the Delaware and Lackawanna, the Delaware and Hudson, the Erie, Ontario and Western. I guess those are all the roads leading to New York directly or indirectly. [He did not name the Central Company because it was a part of the Reading system when he testified.]"

"Q. Those roads are all carrying anthracite coal to the New York harbor?"

"A. Yes, sir."

"Q. And you regard them as competitors who must be considered in fixing rates?"

"A. Yes, sir; unquestionably."

Mr. Harris testified:

"Q. During the time that you were president of the Philadelphia & Reading Railroad Company, from 1893 to 1901, what were the competitive roads in the coal trade with which you came in competition?"

"A. We came in competition with all the roads that were carrying coal from Pennsylvania."

"Q. Name the principal ones in reference to carrying coal from the coal mines to New York harbor."

"A. The Reading, the Lehigh Valley, *the Central Railroad of New Jersey*, the Delaware, Lackawanna and Western, the Erie, and the Pennsylvania Railroad."

That the Reading Coal Company and the Wilkes-Barre Coal Company were competitors before the latter passed under the control of the Holding Company is obvious, but Mr. Baer put this also beyond dispute by testifying:

"Q. Prior to 1901 were the Philadelphia and Reading Coal and Iron Company and the Lehigh and Wilkes-Barre Company competitors as sellers of coal in New York harbor?"

"A. Yes; and they are today."

"Q. And generally throughout the eastern territory they were competitors at that time?"

"A. Yes, sir; through that northern territory. Not in this territory, nor in the southern."

Thus, by this purchase, the Reading Holding Company acquired complete control, not only of one of the largest competitive anthracite carriers, but also of one of the largest competitive coal producing and selling companies, in the country. The anthracite tonnage of the Central and Reading Railway Companies thus combined, exceeded, at the time, 18,000,000 tons,—over one-third of the then total production of the country,—and the revenue derived from it was more than one-third of the total earnings of the two railroad companies.

In 1915 the Interstate Commerce Commission concluded an investigation of the "Rates, practices, rules and regulations governing the transportation of anthracite coal," which had been in progress for three years. The eleven initial anthracite carriers which have lines penetrating the coal producing region were required to furnish special reports as to their anthracite coal transportation operations, and they appeared and participated in the hearing. The result of this exhaustive investigation was that the Commission found: that since about 1901, with variations and exceptions which are negligible here, the carriers have had the same fixed and flat rates to tidewater, regardless of the distance and character of the haul; that these rates were the result of coöperation or combination among the carriers; and that they were excessive to such an extent that material reductions by all of the carriers were ordered, including, of course, those of the Central and Reading companies. The Commission also found, and this appears in the record of this case, that the Reading Coal Company had never paid any dividends on its stock, and that, while the books of the Holding Company showed the Coal Company to have been indebted to it

in a sum exceeding \$68,000,000 for advances of capital made by the Reading *Railroad* Company before the re-organization in 1896, it has paid interest thereon only occasionally and in such small amounts that up to 1913 it fell short by more than \$30,000,000 of equaling 4% per annum on the indebtedness. In the meantime advances of large sums had been made by the Holding Company to the Coal Company and unusual credits had been allowed the latter in the payment of its freight bills. This dealing of the Holding Company with the Reading Coal Company, and similar dealing of the Central Company with the Wilkes-Barre Coal Company and the Navigation Company are denounced by the Commission as unlawful discrimination against other shippers of coal over the rails of these two companies, and, obviously, such favoritism tends to discourage competition and to unduly restrain interstate commerce.

Upon this history of the transactions involved, not controverted save as to some findings of the Interstate Commerce Commission, we must proceed to judgment, and very certainly it makes a case calling for the application of repeated decisions of this court, which clearly rule it.

It will be convenient to first dispose of several minor contentions.

In 1871 the Navigation Company leased the Lehigh & Susquehanna Railroad, which it owned, to the Central Railroad Company, by an instrument containing a covenant which the Government claims requires the Navigation Company to ship to market over the leased line three-fourths of all of the coal which it should produce in the future. This covenant has been amended and supplemented by several agreements but not so as to essentially modify it with respect to the contention we are to consider.

It is argued that this covenant necessarily imposed an undue restriction upon the Navigation Company in

selecting its markets and in shipping its coal, in violation of the Anti-Trust Act.

It is not entirely clear that the covenant will bear the restrictive interpretation as to shipments which the Government puts upon it, but, assuming that it may be so interpreted, nevertheless, the conditions and circumstances of the case considered, the result contended for cannot be allowed.

When the lease was made, in 1871, the Central Railroad extended from Jersey City to its western terminus at Phillipsburg, New Jersey, and it was without access to the coal fields. The Lehigh and Susquehanna Railroad was about 100 miles in length and extended from Phillipsburg into the Wyoming field, where the Navigation Company owned extensive coal producing properties and mines. The lines of the two companies were in no sense competitive, but, on the contrary, the Lehigh and Susquehanna line served as a natural extension of the Central Company's lines to the great tonnage producing coal districts. The rental to be paid was one-third of the gross earnings of the railroad and it was natural and "normal" that the lessor should desire that the traffic should continue to be as large as possible. Plainly this covenant was not written with the purpose of suppressing interstate commerce and the history of its operation shows that, instead of suppressing it, it has greatly promoted it. The claim is quite too insubstantial to be entertained and the decree of the District Court with respect to it will be affirmed and the bill, as to it, dismissed.

In many leases for the operation of coal producing lands the Reading Coal Company and the Wilkes-Barre Coal Company incorporated a covenant that the lessee should ship all coal mined by rail routes, which were named or which were to be designated. Since this covenant was resorted to as a part of the scheme to control the mining and transportation of coal, which is condemned as unlawful in this opinion, the decree of the District Court

enjoining the lessors and the other defendants herein from attempting to enforce such covenants will be affirmed.

The other charges against the Lehigh Coal and Navigation Company and the case stated in the bill with respect to the Wilmington & Northern Railroad Company, the Lehigh & Hudson River Railway Company, and the Lehigh & New England Railroad Company are substantially abandoned in the Government's brief and, having regard to the results arrived at with respect to the principal defendants, the ends of justice will be best served by dismissing the bill as to all of these defendants, without prejudice, as was done by the District Court as to all but the Wilmington and Northern Railroad Company, as to which the dismissal was unqualified. A majority of the individual defendants have died since the suit was instituted and their successors in office have not been made parties, and, since the conclusion to be announced can be given full effect by an appropriate decree against the corporation defendants, the case as against the remaining individual defendants need not be considered, and as to them the bill will be dismissed without prejudice.

We are thus brought to the consideration of what the decree shall be with respect to the really important defendants in the case, the three Reading companies, the Central Railroad Company of New Jersey and the Wilkes-Barre Coal Company.

Before the reorganization of 1896 the gathering of more than two-thirds of the acreage of the Schuylkill field into the control of the two Reading Companies was, as their reports show, for the frankly avowed purpose, then not forbidden by statute, of monopolizing the production, transportation and sale of the anthracite coal of the largest of the three sources of supply.

When in 1896 the problem was presented of reorganizing the financial affairs of the two companies, it was not

solved, as it might have been, by creating separate coal and railroad companies to conduct independently interstate commerce in the two departments to which their railroad and coal properties were adapted, but, on the contrary, and very obviously for the purpose of evading the provision of the constitution of Pennsylvania prohibiting any incorporated common carrier from, directly or indirectly, engaging in mining "articles" for transportation over its lines (Constitution of Pennsylvania, 1874, Art. 17, § 5), and also of evading the provisions of the Federal Anti-Trust Act against restraining and monopolizing interstate commerce, resort was had to the holding company device, by which one company was given unrestricted control over the other two, with the power, inherent in that form of organization, of continuing and carrying forward the restraint and monopoly which had previously been acquired over that large volume of interstate commerce which was to be conducted by the coal and railroad companies.

Again, when in 1901 a rivalry, imaginary or real, arose for the control of the Central Railroad Company, the Holding Company, regardless of the law, did not hesitate to purchase control of that great competing anthracite coal carrying system, with its extensive coal owning and mining subsidiary. This acquisition placed the Holding Company in a position of dominating control not only over two great competing interstate railroad carriers but also over two great competing coal companies, engaged extensively in mining and selling anthracite coal, which must be transported to interstate markets over the controlled interstate lines of railway.

Again, and obviously, this dominating power was not obtained by normal expansion to meet the demands of a business growing as a result of superior and enterprising management, but by deliberate, calculated purchase for control.

That such a power, so obtained, regardless of the use

made of it, constitutes a menace to and an undue restraint upon interstate commerce within the meaning of the Anti-Trust Act, has been frequently held by this court.

Thus, in *Northern Securities Co. v. United States*, 193 U. S. 197, 327, when dealing with a holding company, such as we have here, this court, in 1903, held:

"No scheme or device could more certainly come within the words of the act—'combination in the form of a trust or otherwise . . . in restraint of commerce among the several States or with foreign nations,'—or could more effectively and certainly suppress free competition between the constituent companies. . . . *The mere existence of such a combination and the power acquired by the holding company as its trustee, constitute a menace to, and a restraint upon, that freedom of commerce which Congress intended to recognize and protect, and which the public is entitled to have protected.*"

And again, in *United States v. Union Pacific R. R. Co.*, 226 U. S. 61, 88, decided nine years later, in 1912, this court held:

"The consolidation of two great competing systems of railroad engaged in interstate commerce by transfer to one of a dominating stock interest in the other creates a combination which restrains interstate commerce within the meaning of the statute, because, in destroying or greatly abridging the free operation of competition theretofore existing, it tends to higher rates. . . . Nor does it make any difference that rates for the time being may not be raised and much money be spent in improvements after the combination is effected. *It is the scope of such combinations and their power to suppress or stifle competition or create monopoly which determines the applicability of the act.*"

It will suffice to add that this doctrine was referred to as the settled conclusion of this court, in 1914, when dis-

cussing a similar state Anti-Trust Act in *International Harvester Co. v. Missouri*, 234 U. S. 199, 209, it was said:

"The specification under this head is that the Supreme Court [of Missouri] found, it is contended, benefit—not injury—to the public had resulted from the alleged combination. Granting that this is not an overstatement of the opinion the answer is immediate. *It is too late in the day to assert against statutes which forbid combinations of competing companies that a particular combination was induced by good intention and has had some good effect.* . . . The purpose of such statutes is to secure competition and preclude combinations which tend to defeat it."

Thus, this record clearly shows a group of men selecting the Holding Company with an "omnibus" charter and not only investing it by stock control with such complete dominion over two great competing interstate carriers and over two great competing coal companies extensively engaged in interstate commerce in anthracite coal as to bring it, without more, within the condemnation of the Anti-Trust Act, but it also shows that this power of control was actually used, once successfully, to suppress the building of a prospective competitive railway line, and a second time, successfully until this court condemned the 65% contracts as illegal, to suppress the last prospect of competition in anthracite production and transportation. To this it must be added that up to the time when this suit was commenced this Holding Company had continued in active, dominating control of the Reading Railway Company and of the competing Central Railroad system, and also of the two coal companies, thus effectually suppressing all competition between the four companies and pooling their earnings. It is difficult to imagine a clearer case and in all essential particulars it rests on undisputed conduct and upon perfectly established law. It is ruled by many decisions of this court,

but specifically and clearly by *United States v. Union Pacific R. R. Co.*, *supra*.

For flagrant violation of the first and second sections of the Anti-Trust Act, the relations between the Reading Company, the Reading Railway Company and the Reading Coal Company and between these companies and the Central Railroad Company of New Jersey must be so dissolved as to give to each of them a position in all respects independent and free from stock or other control of either of the other corporations.

With respect to the contention that the commodities clause of the Act of June 29, 1906, 34 Stat. 584, 585, is being violated by the Reading Railway Company and the Central Railroad Company:

The Circuit Judges centering their attention: upon the fact that the Reading Railway Company did not own any of the stock of the Reading Coal Company; that the two companies had separate forces of operatives and separate accounting systems; and upon the importance of maintaining "the theory of separate corporate entity" as a legal doctrine, concluded, upon the authority of *United States v. Delaware & Hudson Co.*, 213 U. S. 366, 413, that the evidence did not justify holding that in transporting the products of the Reading Coal Company's mines to market the Reading Railway Company was carrying a commodity "mined, or produced by it, or under its authority" or which it owned "in whole, or in part," or in which it had "any interest direct or indirect."

But the question which we have presented by this branch of the case is not the technical one of whether ownership by a railroad company of stock in a coal company renders it unlawful for the former to carry the product of the latter, for here the railroad company did not own any of the stock of the coal company. The real question is whether combining in a single corporation the ownership of all of the stock of a carrier and of all of the stock of a coal company results in such community of

interest or title in the product of the latter as to bring the case within the scope of the provisions of the act.

The purpose of the commodity clause was to put an end to the injustice to the shipping public, which experience had shown to result from discriminations of various kinds, which inevitably grew up where a railroad company occupied the inconsistent positions of carrier and shipper. Plainly in such a case as we have here this evil would be present as fully as if the title to both the coal lands and the railroads were in the Holding Company, for all of the profits realized from the operations of the two must find their way ultimately into its treasury,—any discriminating practice which would harm the general shipper would profit the Holding Company. Being thus clearly within the evil to be remedied, there remains the question whether such a controlling stock ownership in a corporation is fairly within the scope of the language of the statute.

In terms the act declares that it shall be unlawful for any railroad company to transport in interstate commerce "any article or commodity . . . mined, or produced by it, or under its authority, or which it may own in whole, or in part, or in which it may have any interest direct or indirect."

Accepting the risk of obscuring the obvious by discussing it, and without splitting hairs as to where the naked legal title to the coal would be when in transit, we may be sure that it was mined and produced under the same "authority" that transported it over the railroad. All three of the Reading companies had the same officers and directors and it was under their authority that the mines were worked and the railroad operated, and they exercised that authority in the one case in precisely the same character as in the other—as officials of the Holding Company. The manner in which the stock of the three was held resulted, and was intended to result, in the abdication of all independent corporate action by both the

Railway Company and the Coal Company, involving as it did the surrender to the Holding Company of the entire conduct of their affairs. It would be to subordinate reality to legal form to hold that the coal mined by the Coal Company, under direction of the Holding Company's officials, was not produced by the same "authority" that operated the Reading Railway lines. The case falls clearly within the scope of the act, and for the violation of this commodity clause, as well as for its violation of the Anti-Trust Act, the combination between the Reading Railway Company and the Reading Coal Company must be dissolved.

The relation between the Central Railroad Company and the Wilkes-Barre Coal Company presents a different question, for here the Railroad Company owns over eleven-twelfths of the stock of the Coal Company, and therefore the holding in 213 U. S. 366, *supra*, is especially pressed in argument,—that the ownership of stock by a railroad company in a coal company does not cause the former to have such an interest in a legal or equitable sense in the product of the latter as to bring it within the prohibition of the act. But this holding was considered in *United States v. Lehigh Valley R. R. Co.*, 220 U. S. 257, 272, and it was there held not applicable where a railroad company used its stock ownership for the purpose of securing a complete control over the affairs of a coal company, and of treating it as a mere agency or department of the owning company. This rule was repeated and applied in *United States v. Delaware, Lackawanna & Western R. R. Co.*, 238 U. S. 516, 529. It results that it may confidently be stated that the law upon this subject now is, that while the ownership by a railroad company of shares of the capital stock of a mining company does not necessarily create an identity of corporate interest between the two such as to render it unlawful under the commodities clause for the railroad company to transport in interstate commerce the products of such mining com-

pany, yet where such ownership of stock is resorted to, not for the purpose of participating in the affairs of the corporation in which it is held in a manner normal and usual with stockholders, but for the purpose of making it a mere agent, or instrumentality or department of another company, the courts will look through the forms to the realities of the relation between the companies as if the corporate agency did not exist and will deal with them as the justice of the case may require. *United States v. Lehigh Valley R. R. Co.*, 220 U. S. 257, 272, 273; *United States v. Delaware, Lackawanna & Western R. R. Co.*, 238 U. S. 516, 529; *Chicago, Milwaukee & St. Paul Ry. Co. v. Minneapolis Civic & Commerce Association*, 247 U. S. 490, 501.

Applying this rule of law to the relation between the Central Railroad Company and the Wilkes-Barre Coal Company, with the former owning over eleven-twelfths of the capital stock of the latter and using it as the coal mining department of its organization, we cannot doubt that it falls within the condemnation of the commodities clause and that this relation must also, for this reason, be dissolved.

It results that the decree of the District Court will be affirmed, as to the Lehigh Coal and Navigation Company, the Lehigh and New England Railroad Company, the Lehigh and Hudson River Railway Company, as to the restrictive covenants in the mining leases with respect to the shipping of coal, as to the dissolution of the combination between the Philadelphia and Reading Coal and Iron Company and the Lehigh and Wilkes-Barre Coal Company, maintained through the Reading Company and the Central Railroad Company of New Jersey. As to the Wilmington and Northern Railroad Company and as to the individual defendants, the bill will be dismissed without prejudice. As to the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company and the

Central Railroad Company of New Jersey, the decree of the District Court will be reversed and the cause remanded with directions to enter a decree in conformity with this opinion, dissolving the combination of the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh and Wilkes-Barre Coal Company, held by the Central Railroad Company of New Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all of these now combined companies may be conducted in harmony with the law.

Affirmed in part; reversed in part, and remanded with direction to enter a decree in conformity with this opinion.

MR. CHIEF JUSTICE WHITE, MR. JUSTICE HOLMES and MR. JUSTICE VAN DEVANTER, dissenting.

Except in so far as the decree below commanded a separation of interest between the Central Railroad of New Jersey and the Lehigh & Wilkes-Barre Coal Company, the court below dismissed, for want of equity, the bill of the United States brought to sever the existing relations between the Reading Company, the Philadelphia

& Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad of New Jersey, the Lehigh & Wilkes-Barre Coal Company, and other corporations, on the ground that the relations between those companies resulted in a monopoly or combination in restraint of trade in violation of the Sherman Act and gave rise to a disregard of the commodities clause of the act of Congress.

By the opinion now announced, this action of the court below, in so far as it directed a dismissal, is reversed and virtually the full relief prayed by the Government is therefore granted. We are unable to concur in this conclusion because in our opinion neither the contentions as to the Sherman Act, nor the reliance upon the commodities clause, except to the extent that in the particulars stated they were sustained by the court below, have any foundation to rest upon. We do not state at any length the reasons which lead us to this view because the court below, composed of three circuit judges, in a comprehensive and clear opinion announced by McPherson, Judge, sustains the correctness of the action which it took and also demonstrates the error involved in the decree of this court reversing its action. *United States v. Reading Co.*, 226 Fed. Rep. 229. To that opinion we therefore refer as stating the reasons for our dissent.

Mandate.

(Filed August 13, 1920).

UNITED STATES OF AMERICA, ss:

THE PRESIDENT OF THE UNITED STATES OF AMERICA,

[SEAL] To the Honorable the Judges of the District Court
of the United States for the Eastern District
of Pennsylvania.

GREETING:

WHEREAS, lately in the District Court of the United States for the Eastern District of Pennsylvania, before you, or some of you, in a cause between The United States of America, petitioner, and Reading Company, Philadelphia & Reading Railway Company, *et al.*, defendants, No. 1095, September Sessions, 1913, wherein the decree of the said District Court, entered in said cause on the 28th day of October, A. D. 1915, is in the following words, viz:

"This cause having come on for final hearing upon pleadings and proofs, and having been argued by counsel before three circuit Judges sitting under the provisions of the expediting act of February 11, 1903 (32 Stat. 823), as amended June 25, 1910 (36 Stat., 854); and the pleadings, proofs, and arguments having been considered, and the opinion of the Court having been filed; it is now, this 28th day of October, 1915, ordered, adjudged and decreed;

1. Except as hereinafter provided, the bill, or petition, is dismissed.

2. The charge therein contained, namely, that the lease of the Lehigh & Susquehanna Railroad made between the Lehigh Coal & Navigation Company and the Central Railroad Company of New Jersey, contained in the writings dated respectively March 31, 1871, May 27, 1883, and June 28, 1887, is in violation of the anti-trust act of July 2, 1890 (26 Stat., 209, c. 647) is not sustained, and in respect thereof the petition is dismissed. But, in respect of all other charges against the Lehigh Coal & Navigation Company, and in respect of all charges against the Lehigh

& New England Railroad Company, and the Lehigh & Hudson River Railway Company, the petition is dismissed without prejudice.

3. The charge that the Central Railroad Company is violating the commodities clause of the act to regulate commerce (34 Stat., 584, c. 3591), is dismissed, but without prejudice.

4. The union of the Philadelphia & Reading Coal & Iron Company and the Lehigh & Wilkes-Barre Coal Company through the instrumentality of the Reading Company, a holding corporation—which owns the entire capital stock of the Philadelphia & Reading Coal & Iron Company and a majority of the capital stock of the Central Railroad Company, the last named company owning in turn a majority of the capital stock of the Lehigh & Wilkes-Barre Coal Company—is a combination in restraint of trade and violates the antitrust act of July 2, 1890 (26 Stat., 209, c. 647).

5. Within 90 days from the entry of this decree—or in case an appeal be taken therefrom to the Supreme Court of the United States and duly prosecuted, then within 90 days after the filing in this court of the mandate of the Supreme Court affirming the decree—the defendants shall submit to this court a plan for the disposal by the Central Railroad Company of all the stock, bonds, or other securities of the Lehigh & Wilkes-Barre Coal Company now owned or in any manner controlled by it; the plan to be such as will effectually dissolve the unlawful combination and create a situation in harmony with law. If the defendants shall fail to present a plan within the period stated, or if the plan submitted shall be rejected, this court will take such further steps, by receivership or otherwise as may then seem necessary, to dispose of the stock, bonds and securities referred to, and to dissolve effectually the unlawful combination, so as to create a situation in harmony with law. For this purpose the Court retains jurisdiction of the cause.

6. Pending the disposal of the stock, bonds, and securities referred to, the Central Railroad Company, the Reading Company, and all corporations con-

trolled by them or either of them, or subject to a common control with them or either of them, through stock ownership or otherwise, their officers, directors, agents and employees, are hereby enjoined from voting or attempting to vote on any stock of the Lehigh & Wilkes-Barre Coal Company, from collecting or receiving any dividends or interest upon its stock, bonds, or other securities, and from exercising or attempting to exercise any control, direction, supervision, or influence whatever over its acts, either by proxies from other stockholders or otherwise. And the Central Railroad Company, the Reading Company, and all corporations controlled by them or either of them, or subject to a common control with them or either of them, through stock ownership or otherwise, their officers, directors, agents, and employees, are perpetually enjoined from hereafter acquiring, directly or indirectly, any interest in or control over the stock, bonds, or other securities of the Lehigh & Wilkes-Barre Coal Company or any control over said company. And the Central Railroad Company is hereby enjoined from requiring, or attempting or threatening to require, the Lehigh & Wilkes-Barre Coal Company or any of its subsidiary companies to ship all or any part of their coal tonnage over any railroad or line of transportation operated or designated by the Central Railroad Company.

7. All clauses, stipulations, or covenants in leases of coal lands made by the Philadelphia & Reading Coal & Iron Company, or by the Lehigh & Wilkes-Barre Coal Company, or by any company subsidiary to or controlled by either, that require or purport to require the lessees to ship coal over any particular railroad or railroads, or over such route as may be designated by any railroad company or companies, are hereby declared to violate the antitrust act of July 2, 1890, and therefore to be void; and the coal companies and the railroad Companies that are parties to this decree, their officers, directors, agents, and employees, are hereby enjoined from enforcing or attempting to enforce or threatening to enforce such clauses, stipulations or covenants.

8. The Government is entitled to recover from the Reading Company so much of its taxable costs in the

district court as relate to the subject-matter of the fourth, fifth and seventh sections of this decree.

JOS. BUFFINGTON

WILLIAM H. HUNT

JOHN B. MCPHERSON

United States Circuit Judges."

as by the inspection of the transcript of the record of the said District Court, which was brought into the SUPREME COURT OF THE UNITED STATES by virtue of an appeal and a cross-appeal, agreeably to the act of Congress in such case made and provided, fully and at large appears.

AND WHEREAS, in the present term of October, in the year of our Lord one thousand nine hundred and nineteen, the said cause came on to be heard before the said Supreme Court, on the said transcript of record, on appeal and cross-appeal, and was argued by counsel:

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged, and decreed by this Court that the decree of the said District Court in this cause be, and the same is hereby affirmed in part and reversed in part.

AND IT IS FURTHER ORDERED that this cause be, and the same is hereby remanded to the said District Court with direction to enter a decree in conformity with the opinion of this Court.

APRIL 26, 1920.

You, therefore, are hereby commanded that such further proceedings be had in said cause, in conformity with the opinion and decree of this Court, as according to right and justice, and the laws of the United States, ought to be had, the said appeals notwithstanding.

Witness the Honorable EDWARD D. WHITE, Chief Justice of the United States, the fifteenth day of June, in the year of our Lord one thousand nine hundred and twenty.

(Sgd) JAMES D. MAHER

Clerk of the Supreme Court of the United States.

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

THE UNITED STATES OF AMERICA, Petitioner,

v.

READING COMPANY, PHILADELPHIA & READING RAILWAY COMPANY, THE PHILADELPHIA & READING COAL & IRON COMPANY, THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, THE LEHIGH & WILKES-BARRE COAL COMPANY, THE LEHIGH COAL & NAVIGATION COMPANY, WILMINGTON & NORTHERN RAILROAD COMPANY, LEHIGH & HUDSON RIVER RAILWAY COMPANY, LEHIGH & NEW ENGLAND RAILROAD COMPANY, GEORGE F. BAER, GEORGE F. BAKER, EDWARD T. STOTESBURY, HENRY C. FRICK, PETER A. B. WIDENER, HENRY A. DUPONT, DANIEL WILLARD, HENRY P. MCKEAN, and SAMUEL DICKSON, Defendants.

Decree on Mandate.

(Filed October 8, 1920.)

The above entitled cause having come on for hearing before this Court at the March Term, 1914, and having been determined in part in favor and in part against the

petitioner, and the said cause having been appealed by both parties to the Supreme Court of the United States, and that court having affirmed in part and in part reversed the decree of this Court, and a mandate from the Supreme Court in proper form containing directions as to the decree to be entered having been filed here on the 13th day of August, 1920:

Now, therefore, this cause having come on for hearing at the present term, and the Court being fully advised in the premises, doth hereby order, adjudge and decree:

PART I. FINDINGS.

FIRST. That Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey, and The Lehigh & Wilkes-Barre Coal Company, have been and are engaged in a combination in restraint of interstate trade and commerce in the production, sale, and transportation of anthracite coal in violation of Section 1 of the Act of Congress approved July 1, 1890, entitled, "An Act to protect against unlawful restraints and monopolies."

SECOND. That Reading Company, Philadelphia & Reading Railway Company, The Philadelphia and Reading Coal & Iron Company, The Central Railroad Company of New Jersey, and The Lehigh & Wilkes-Barre Coal Company, have been and are monopolizing and attempting to monopolize a part of interstate trade and commerce in the production, sale, and transportation of anthracite coal in violation of Section 2 of the Act of Congress approved July 2, 1890, entitled "An Act to protect trade and commerce against unlawful restraints and monopolies."

THIRD. That the transportation in interstate commerce by Philadelphia & Reading Railway Company of anthracite coal mined or owned by the Philadelphia & Reading Coal & Iron Company, in view of the relations existing between those companies as set forth in the opinion of the Supreme Court, has been and is in violation of the so-called Commodities Clause of the Act to Regulate Commerce as amended June 29, 1906.

FOURTH. That the transportation in interstate commerce by The Central Railroad Company of New Jersey of anthracite coal mined or owned by The Lehigh & Wilkes-Barre Coal Company, in view of the relations existing between those companies as set forth in the opinion of the Supreme Court, has been and is in violation of the so-called Commodities Clause of the Act to Regulate Commerce as amended June 29, 1906.

PART II. AS TO THE FORMER DECREE.

And it is further ordered, adjudged and decreed;

FIRST. That except in the particulars hereinafter specifically mentioned, the final decree entered herein on October 28, 1915 be, and the same is hereby, reversed and set aside.

SECOND. That the provision of said decree dismissing the petition as to the defendants George F. Baer, George F. Baker, Edward T. Stotesbury, Henry C. Frick, Peter A. B. Widener, Henry A. duPont, Daniel Willard, Henry P. McKean and Samuel Dickson (or the survivors of them), and the Wilmington & Northern Railroad Company, is reversed; and the petition as to these defendants is dismissed, without prejudice.

THIRD. That the provision of said decree dismissing the Government's petition in so far as the same related

to the lease of the Lehigh & Susquehanna Railroad by the Lehigh Coal & Navigation Company to the Central Railroad Company of New Jersey, be and the same is hereby affirmed.

FOURTH. That the provision of said decree dismissing without prejudice the Government's petition in so far as the same related to all other charges against the Lehigh Coal & Navigation Company, and in respect of all charges against the Lehigh & New England Railroad Company and the Lehigh & Hudson River Railway Company, be and the same is hereby affirmed.

FIFTH. That paragraph 4 of said decree providing as follows:

The union of the Philadelphia & Reading Coal & Iron Co. and the Lehigh & Wilkes-Barre Coal Co. through the instrumentality of the Reading Co., a holding corporation—which owns the entire capital stock of the Philadelphia & Reading Coal & Iron Co. and a majority of the capital stock of the Central Railroad Co., the last-named company owning in turn a majority of the capital stock of the Lehigh & Wilkes-Barre Coal Co.—is a combination in restraint of trade and violates the anti-trust act of July 2, 1890 (26 Stat. 209, c. 647).

be and the same is hereby affirmed.

SIXTH. That paragraph 5 of said decree providing as follows:

Within 90 days from the entry of this decree, or in case an appeal be taken therefrom to the Supreme Court of the United States and duly prosecuted, then within 90 days after the filing in this court of the mandate of the Supreme Court affirming the decree, the defendants shall submit to this court a plan for the disposal by the Central Railroad Co. of all the stock, bonds, or other securities of the Lehigh & Wilkes-Barre Coal Co. now owned or in any man-

ner controlled by it; the plan to be such as will effectually dissolve the unlawful combination and create a situation in harmony with law. If the defendants shall fail to present a plan within the period stated, or if the plan submitted shall be rejected, this court will take such further steps, by receivership or otherwise as may then seem necessary, to dispose of the stock, bonds, and securities referred to, and to dissolve effectually the unlawful combination, so as to create a situation in harmony with law. For this purpose the court retains jurisdiction of the cause.

be and the same is hereby affirmed.

SEVENTH. That paragraph 6 of said decree providing as follows:

Pending the disposal of the stock, bonds and securities referred to, the Central Railroad Co., the Reading Co., and all corporations controlled by them or either of them, or subject to a common control with them or either of them, through stock ownership or otherwise, their officers, directors, agents, and employees, are hereby enjoined from voting or attempting to vote on any stock of the Lehigh & Wilkes-Barre Coal Co., from collecting or receiving any dividends or interest upon its stock, bonds, or other securities, and from exercising or attempting to exercise any control, direction, supervision, or influence whatever over its acts, either by proxies from other stockholders or otherwise. And the Central Railroad Co., the Reading Co., and all corporations controlled by them or either of them, or subject to a common control with them or either of them, through stock ownership or otherwise, their officers, directors, agents, and employees, are perpetually enjoined from hereafter acquiring, directly or indirectly, any interest in or control over the stock, bonds, or other securities of the Lehigh & Wilkes-Barre Coal Co., or any control over said company. And the Central Railroad Co., is hereby enjoined from requiring, or attempting or threatening to require, the Lehigh & Wilkes-Barre Coal Co. or

any of its subsidiary companies to ship all or any part of their coal tonnage over any railroad or line of transportation operated or designated by the Central Railroad Co.

be and the same is hereby affirmed.

EIGHTH. That paragraph 7 of said decree providing as follows:

All clauses, stipulations, or covenants in leases of coal lands made by the Philadelphia & Reading Coal & Iron Co. or by the Lehigh & Wilkes-Barre Coal Co., or by any company subsidiary to or controlled by either, that require or purport to require the lessees to ship coal over any particular railroad or railroads, or over such route as may be designated by any railroad company or companies, are hereby declared to violate the antitrust act of July 2, 1890, and therefore to be void; and the coal companies and the railroad companies that are parties to this decree, their officers, directors, agents, and employees, are hereby enjoined from enforcing or attempting to enforce, or threatening to enforce, such clauses, stipulations, or covenants.

be and the same is hereby affirmed.

PART III. PROVISIONS RELATING TO DISSOLUTION.

And it is further ordered, adjudged and decreed:

FIRST. That within 90 days from the entry of this decree the defendants shall submit to this court a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with

such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law.

SECOND. That the court upon application of the defendants and upon an adequate showing of the necessity therefor, may grant an extension of the time in which to submit said plan of dissolution; *Provided*, that the plan for the separation of the Central Railroad Company of New Jersey and The Lehigh & Wilkes-Barre Coal Company which defendants are required to submit by paragraph sixth of Part II of this decree, may be included in and submitted along with the general plan of dissolution provided for in the above paragraph; *Provided further*, that the United States may have 30 days from and after the submission of any plan in which to file its suggestions, which suggestions the Court may request the United States to embody in a plan of dissolution to be framed by it.

THIRD. That if the defendants shall fail to present a plan within the period stated, or within any period allowed by the court by way of extension, this court will take such further steps as may then seem necessary to dispose of the stock, bonds, and property referred to, and to dissolve effectually the unlawful combination, so as to recreate out of the elements composing said combination a new situation in harmony with law. For this purpose the court retains jurisdiction of the cause.

PART IV. INJUNCTIVE PROVISIONS.

And it is further ordered, adjudged and decreed:

FIRST. That pending the disposal by the Reading Company of the stocks, bonds, and other property of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, and The Central Railroad Company of New Jersey, the Reading Company and all corporations controlled by it through stock ownership or otherwise, their officers, directors, agents and employees, be and they are hereby enjoined from voting or attempting to vote any stock of the said Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, or The Central Railroad Company of New Jersey, and from exercising or attempting to exercise any control over the corporate policies of these Companies in such a manner as to interfere with their independence of action pending the final decree of this Court; *Provided*, That nothing in this decree contained shall prevent the Reading Company or its officers, agents, or employees from voting the stock of, or exercising control over, the Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, and The Central Railroad Company of New Jersey, in such way and to such extent as may be expressly approved by this court for the purpose of carrying out this decree.

SECOND. Pending the dissolution of the combination and the re-creation from the elements now composing it of a new condition honestly in harmony with the law under the direction of this court, all the defendants, their agents and servants, are hereby restrained and enjoined from doing any act which might further extend or enlarge the power of the combination by any means or devices whatsoever.

PART V. Costs.

And be it further ordered, adjudged, and decreed :

FIRST. That the petitioner, the United States of America, have and recover from the defendants, the Reading Company, Philadelphia and Reading Railway Company, Philadelphia & Reading Coal and Iron Company, The Central Railroad Company of New Jersey, and The Lehigh & Wilkes-Barre Coal Company, its costs and disbursements to be taxed by the Court.

JOS. BUFFINGTON

VICTOR B. WOOLLEY

J. WARREN DAVIS

Circuit Judges.

Dated October 8, 1920.

Plan of Reading Company.

IN THE

DISTRICT COURT OF THE UNITED STATES

FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

THE UNITED STATES OF AMERICA, Petitioner,

VS.

READING COMPANY, PHILADELPHIA & READING RAILWAY COMPANY, THE PHILADELPHIA & READING COAL & IRON COMPANY, THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, THE LEHIGH & WILKES-BARRE COAL COMPANY, THE LEHIGH COAL & NAVIGATION COMPANY, WILMINGTON & NORTHERN RAILROAD COMPANY, LEHIGH & HUDSON RIVER RAILWAY COMPANY, LEHIGH & NEW ENGLAND RAILROAD COMPANY, GEORGE F. BAER, GEORGE F. BAKER, EDWARD T. STOTESBURY, HENRY C. FRICK, PETER A. B. WIDENER, HENRY A. DUPONT, DANIEL WILLARD, HENRY P. MCKEAN and SAMUEL DICKSON, Defendants.

(Filed Feb. 14, 1921.)

In pursuance of the decree of mandate of this Court entered October 8th, 1920, defendants, Reading Company Philadelphia and Reading Railway Company, and Th

Philadelphia & Reading Coal & Iron Company, respectfully submit the following plan:—

1. The Reading Company will assume the \$96,524,000 General Mortgage 4% bonds, which are a joint obligation of the Reading Company and The Philadelphia & Reading Coal & Iron Company (hereinafter called the Coal Company), and will agree to save the Coal Company and its property harmless therefrom.

2. The Coal Company will pay to the Reading Company \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in 4% mortgage bonds of the Coal Company. The mortgage under which they are to be issued may contain provision for the issue thereunder of additional bonds to provide for additions, betterments and improvements to a limited amount, to be determined by the Reading Company and the Coal Company prior to the creation of the mortgage, and shall contain provision for a proper sinking fund for the retirement of bonds issued thereunder. The \$25,000,000 bonds issued by the Coal Company to the Reading Company shall mature on January 1, 1997, the same date as the General Mortgage bonds. The bonds issued by the Coal Company shall be subject to redemption at par and accrued interest on any semi-annual interest date as a whole but not in part, except out of the moneys in the sinking fund.

3. Except as otherwise herein expressly provided, general releases of all claims and liabilities as between the Reading Company and the Coal Company, including the claim of approximately \$70,000,000 carried on the books of the Reading Company as an asset and on the books of the Coal Company as a liability, will be exchanged.

4. The Reading Company will agree that it will obtain the release of the coal property from the lien of the General Mortgage and the discharge of the Coal Company

from liability on the General Mortgage bonds, provided such release and discharge can be secured by payment by the Reading Company to the bondholders of a premium not exceeding 10% upon the par value of the outstanding General Mortgage bonds. Such release and payment will be made from time to time as the acquiescence of the several bondholders shall be given. The Reading Company will make payment of said premium on the order of the committee to be formed in the interest of the bondholders. Said committee will call for the deposit of bonds and will be authorized by the depositors to return to them their bonds stamped as assenting to the release and discharge above mentioned, or to return to them, in the discretion of the committee, refunding and improvement mortgage bonds of the Reading Company hereinafter described for an equal principal amount and bearing 4% interest. Though the committee will order payment of the premium from time to time as the bonds are deposited, it will, in the first instance, cause to be issued depository receipts for the General Mortgage bonds and will retain the General Mortgage bonds until it shall have determined that a sufficient percentage of bonds has been deposited to declare in effect the plan of exchange for refunding and improvement mortgage bonds, or that in its judgment it is improbable that a sufficient amount of bonds will be so deposited. Upon such determination it shall deliver to the holders of the depository receipts the refunding and improvement mortgage bonds or General Mortgage bonds stamped as aforesaid, as the case may be. The depository will collect and pay out the interest on the deposited bonds pending the determination of the committee as aforesaid.

5. It is assumed that the Attorney General will ask the Court to direct the release of the stock of the Coal Company from the lien of the General Mortgage on such terms as the Court may fix. If practicable the Coal Com-

pany will consolidate with Delaware Coal Company, of which it owns the entire capital stock, and the consolidated company will issue stock without par value to the Reading Company. If that is not practicable, a new corporation will be created to acquire from the Reading Company the stock of the Coal Company, or the interest of the Reading Company therein, and such new corporation will issue no par value stock. The number of shares to be issued of the consolidated Coal Company or of such new corporation may be 1,400,000.

Such no par value stock will be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000., or \$2.00 for each share of Reading Stock. It is proposed to carry out this sale, in accordance with the precedent established by the Union Pacific-Southern Pacific case, by distributing to Reading stockholders assignable certificates of interest in the Coal Company stock exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of Reading Company. Any further steps, which may be deemed necessary by the Court, will be taken to the end that an independent board and management to be approved by it will be maintained for the Coal Company, so that the independence of this company need not await the necessarily gradual process of the distribution of the stock of the Coal Company among persons not holders of stock in the Reading Company.

6. The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage. The name of the Reading Company, after merger, will not be changed. The Reading Company will accept the Pennsylvania Constitution of 1874, and it will proceed under the Act of 1856 to sur-

render those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated.

7. If and whenever the General Mortgage bondholders' committee shall determine to declare the plan of exchange effective, the Reading Company shall execute a refunding and improvement mortgage, which shall constitute a direct lien upon all the railroads, railroad property, railroad equipment and railroad stocks and bonds then owned by the Reading Company or thereafter acquired by means of bonds issued thereunder. Deposited General Mortgage bonds will be kept alive under said refunding and improvement mortgage until the General Mortgage is released. The refunding and improvement mortgage will contain appropriate provision for the reservation of bonds to refund outstanding General Mortgage bonds and other prior lien bonds or obligations. It will be an open mortgage in modern form with appropriate provision for the issue of additional bonds for the acquisition of new property and for additions, betterments and improvements to the mortgaged property.

8. The Court will be asked to defer the actual sale of the stock held by the Reading Company in the Central Railroad of New Jersey pending the grouping of railroads by the Interstate Commerce Commission under the Transportation Act, but subject to the further order of the Court. It is assumed that the Attorney General will ask the Court to make an order assuring the voting of the stock pending such sale in the manner approved by the Court. A detailed plan for the prompt disposition of the

stock of the Lehigh and Wilkes-Barre Coal Company by the Central Railroad of New Jersey has been submitted separately.

WM. CLARKE MASON,
R. C. LEFFINGWELL,
CHAS. HEEBNER,
Of Counsel.

Dated, February 14th, 1921.

Counter Proposal by the United States to Paragraph Eight of the
Plan of Reading Company.

(Filed Feb. 14, 1921.)

Comes now the United States by Frank K. Nebeker, Assistant to the Attorney General, and Abram F. Myers, Special Assistant to the Attorney General, and respectfully represent unto the Court that the provision in the plans submitted by the defendants for the placing in the hands of a trustee of Reading Company's interest in the stock of the Central Railroad Company of New Jersey, pending the working out of a plan for the re-grouping of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, is not a satisfactory compliance with the requirements of the Supreme Court.

Complying with the requirement in the interlocutory decree that the United States shall embody its suggestions in reference to the defendants' plan in a plan of its own, the United States respectfully suggests that the following paragraphs be substituted for paragraph eight of the defendants' plan:—

“Reading Company shall, with all due diligence, offer for sale at a reasonable price and upon reasonable terms the stock of the Central Railroad Company of New Jersey now owned by it for a period of years. If at the expiration of such period a sale of such stock has not been made, then, upon application of the Attorney General, the Court

may decree a sale at public auction at a price not less than a minimum price to be agreed upon between the Reading Company and the Attorney General. During this period Reading Company shall accept any offer by a responsible purchaser made in good faith and at a reasonable price and in the event of any disagreement between an intending purchaser, who has complied with the foregoing provisions, and the Reading Company, then the matter shall be referred to the Attorney General for his advice and if the parties shall still be at a disagreement, then any party (Reading Company, the United States, or the intending purchaser) may bring the matter to the attention of the Court for its decision. A purchaser under this provision must be approved by the Attorney General, and, if a railroad company, shall apply to the Interstate Commerce Commission for its authority to make such purchase under paragraphs two and three of Section 407 of the Transportation Act of 1920.

"For the purposes of carrying out such a provision, jurisdiction of the case shall be retained by the Court."

The suggestions of the Government in reference to the other provisions of defendants' plan, which suggestions relate only to matters of detail, are embodied in the memorandum attached hereto.

FRANK K. NEBEKER,

Assistant to the Attorney General.

A. F. MYERS,

Special Assistant to the Attorney General.

Order.

(Filed Feb. 14, 1921.)

The above case, having come before the Court for further hearing, this fourteenth day of February, A. D. 1921, and, pursuant to the decree of this Court heretofore

entered, a plan for the dissolution of the combination between the Reading Company, the Philadelphia and Reading Railway Company, The Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey, and the Lehigh and Wilkes-Barre Coal Company, having been presented to the Court on behalf of the said companies, and the suggestions of the United States relating to the said plan having also been presented to the Court,

And the Court having been fully advised in the premises by the Attorney General of the United States and counsel for the said companies, defendants;

It is hereby ordered, adjudged and decreed:—

FIRST.—That a copy of the said plan and the suggestions of the United States relating thereto be served upon the Central Union Trust Company, of New York, Trustee under the General Mortgage referred to in the said plan.

SECOND.—That copies of the said plan and the suggestions of the United States relating thereto be filed in the office of the clerk of this Court and with the secretary of the Reading Company at the offices of the said Company in Philadelphia and New York, to be open to the inspection of all stockholders of the said companies, defendants, during the business hours of the said Company.

THIRD.—That on the first day of March, A. D. 1921, at 1.30 o'clock in the afternoon, the Attorney General of the United States and counsel for the defendants will be heard further on the proposed plan and in regard to the subject matter thereof.

Per Curiam,

JB.

**Supplemental Bill by the United States to make Central Union Trust
Company of New York a party to the cause.**

(Filed March 1, 1921.)

TO THE HONORABLE JUDGES OF THE ABOVE NAMED COURT:

Comes now the United States, complainant in the above-entitled cause, by Frank K. Nebeker, Assistant to the Attorney General, and Abram F. Myers, Special Assistant to the Attorney General, and having first obtained leave of Court, files this supplemental bill of complaint alleging as follows:

1. That on the 2nd day of September, 1913, complainant exhibited its original bill of complaint in this Honorable Court against Reading Company and its several corporate subsidiaries and certain others, alleging that the defendants were engaged in a combination in restraint of trade and a monopoly in violation of Sections 1 and 2 of the so-called Sherman Anti-Trust Act of July 2, 1890, and that certain of the defendants were transporting anthracite coal in interstate commerce in violation of the so-called Commodities Clause of the Act to Regulate Commerce as amended June 29, 1906.

2. That by final decree entered by this Court on the 28th day of October, 1915, this cause was determined in part in favor of the complainant and in part in favor of the defendants, and from this decree cross-appeals were taken to the Supreme Court of the United States, where such final decree was in part affirmed and in part reversed, and a mandate in due form from the Supreme Court has been filed in this Court containing directions for the entry of a decree in conformity with the Supreme Court's opinion.

3. That the Central Union Trust Company of New York is a corporation of New York with offices at No. 80

Broadway, and is the trustee under the General Mortgage executed by defendants Reading Company and Philadelphia and Reading Coal and Iron Company on January 5, 1897, as in the original bill, the record, and opinions in this case more particularly set forth.

4. That the aforesaid General Mortgage is the joint obligation of the defendants Reading Company and Philadelphia & Reading Coal & Iron Company and was executed to secure the issue of \$135,000,000 of General Mortgage 4 per cent. bonds. Under and by virtue of said General Mortgage defendant Reading Company has pledged with the Central Union Trust Company of New York, as trustee, numerous stocks and bonds, including the entire capital stock of Philadelphia & Reading Coal & Iron Company, and defendant Reading Coal & Iron Company has conveyed to said trustee (subject to the conditions of the mortgage) its entire physical property.

5. That pursuant to the interlocutory decree entered in this cause on October 8, 1920, defendants have presented to the Court a plan for the dissolution of the unlawful combination existing between the defendants Reading Company, Philadelphia & Reading Railway Company, Philadelphia & Reading Coal & Iron Company, Central Railroad Company of New Jersey, and Lehigh & Wilkes-Barre Coal Company, which plan provides, among other things, for the release of the stock of Reading Coal & Iron Company from the lien of the General Mortgage and the disposition thereof through the stockholders of Reading Company to independent interests, and also for the release of all the property of the Coal Company from the lien of said mortgage and the assumption of the entire obligation thereof by Reading Company.

6. Your petitioner believes and therefore alleges that in order effectually to carry out the plan thus presented

for the dissociation of Reading Company and Reading Coal & Iron Company the said Central Union Trust Company of New York should be made a party defendant to this cause and thus be made subject to any further interlocutory orders or final decree which may be entered herein affecting the stock or property of Reading Coal & Iron Company pledged with said Trust Company under said General Mortgage as security for the before-mentioned 4 per cent. bonds.

To the end, therefore, that said Central Union Trust Company may be made a party defendant to the above-entitled cause, and may be afforded the opportunity to show cause (if cause it has) why the said plan for the dissociation of Reading Company and Reading Coal & Iron Company should not be approved by this Court, and that complainant may have such further general and special relief as the nature of the case may require, may it please the Court to grant to the complainant a writ of subpœna directed to the said Central Union Trust Company commanding it to appear and make answer to the premises and abide by and perform such orders and decrees as to the Court may seem proper.

FRANK K. NEBEKER

Assistant to the Attorney General.

ABRAM F. MYERS

Special Assistant to the Attorney General.

UNITED STATES OF AMERICA, }
District of Columbia, } ss

I, ABRAM F. MYERS, being first duly sworn, say that I am a Special Assistant to the Attorney General, and under the direction of the Attorney General and the Assistant to the Attorney General represent the United States in the above-entitled cause; that I have read the foregoing

supplemental bill and have personal knowledge of the facts therein narrated, and the facts therein alleged as true are true and the facts alleged upon information and belief I verily believe to be true.

ABRAM F. MYERS.

Subscribed and sworn to before me this 28th day of February, 1921.

FODIE B. KENYON,

Notary Public, D. C.

[SEAL]

IN THE
DISTRICT COURT OF THE UNITED STATES
WITHIN AND FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

THE UNITED STATES OF AMERICA,
Petitioner,

AGAINST

READING COMPANY, *et al.*,
Defendants.

In Equity
No. 1095.

Petition of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York for leave to intervene.

(Filed March 15, 1921.)

TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
OF THE UNITED STATES WITHIN AND FOR THE EASTERN
DISTRICT OF PENNSYLVANIA:

Now come CONTINENTAL INSURANCE COMPANY, a corporation organized and existing under the laws of the State of New York, and FIDELITY-PHENIX FIRE INSURANCE

COMPANY OF NEW YORK, likewise a corporation organized and existing under the laws of the State of New York, and as owners and holders of common stock of the defendant Reading Company present this their petition, and respectfully represent unto this Honorable Court as follows:

1. Your petitioners are each a corporation organized and existing under the laws of the State of New York, and are duly and lawfully authorized to own and hold shares of the capital stock of the defendant Reading Company (hereinafter called Reading Company), and the Continental Insurance Company is the owner and holder of 4,200 shares of Common Stock of the Reading Company and the Fidelity-Phenix Fire Insurance Company of New York is likewise the owner and holder of 4,200 shares of said Common Stock.

2. At a hearing had herein on March 1, 1921, this Honorable Court, by oral order, granted to parties in interest leave to file petitions with respect to the segregation of the properties of the Reading Company and in respect to the Plan for such segregation dated February 14, 1921 (hereinafter referred to as the Plan), submitted to this Honorable Court, and pursuant to leave so granted, your petitioners present this their petition, and beg leave that they be permitted to intervene and object to said Plan and present suggestions for the modification thereof.

ON INFORMATION AND BELIEF

3. The Plan presented to this Honorable Court, by reason of the matters hereinafter set forth, directs in its essence and in effect, a distribution of the surplus and accumulated net earnings of the Reading Company to the holders of the Preferred and Common Stock of the Reading Company upon equal terms, whereas in truth and in fact the

holders of the Common Stock of the Reading Company are, by reason of the matters hereinafter set forth, solely entitled to share in any distribution from such accumulated surplus (excepting only such portion thereof as represents net profits of fiscal years in which "full" dividends, to wit, 4%, were not paid on the First and Second Preferred Stock of the Reading Company) and the aforesaid Plan further directs the payment of approximately \$10,000,000 by the Reading Company to holders of General Mortgage Bonds, as a premium for the release of certain properties from the lien of the General Mortgage securing same, executed by the Reading Company and the Philadelphia & Reading Coal & Iron Company to Central Trust Company of New York, as Trustee, dated January 5, 1897, notwithstanding that such payment and such release are unnecessary to carry out the Decree of Mandate of October 8, 1920, of this Honorable Court and that no equivalent consideration or benefit will accrue therefrom to the Reading Company.

4. In and by a Plan and Agreement, dated December 14, 1895, provision was made for the reorganization of certain properties theretofore owned by the Philadelphia & Reading Railroad Company and the Philadelphia & Reading Coal & Iron Company (hereinafter called the Coal Company). Said Plan and Agreement of Reorganization provided for the issuance by the New Company to be organized thereunder, of \$28,000,000 par value of First Preferred Stock, \$42,000,000 par value of Second Preferred Stock, and \$70,000,000 par value of Common Stock.

With respect to the right to dividends on the First and Second Preferred Stock of such New Company it was provided in and by said Plan and Agreement of Reorganization as follows:

" . . . The First Preferred Stock will entitle the holders to non-cumulative dividends up to 4

per cent. per annum, payable out of net earnings before any dividend shall be paid on the Second Preferred or the Common Stock.

"Non-cumulative 4% Second Preferred Stock . . . which will entitle the holders to non-cumulative dividends up to 4 per cent. per annum, payable out of net earnings before any dividend shall be paid on the Common Stock."

5. Pursuant to an Act of the Legislature of the Commonwealth of Pennsylvania, entitled "An Act to Incorporate the Excelsior Enterprise Company, with power to purchase, improve, use and dispose of property, to aid contractors and others, and for other purposes", approved May 24, 1871, a corporation was organized known as the "Excelsior Enterprise Company".

In and by said Act approved May 24, 1871, the said Excelsior Enterprise Company received the same powers, privileges, franchises and immunities, as had theretofore been conferred in and by an Act of the Legislature of the Commonwealth of Pennsylvania entitled "An Act to Incorporate the Pennsylvania Company" approved April 7, 1870, and also the same powers, privileges, franchises and immunities as had been granted in and by any then existing supplements to the charter of the Pennsylvania Company conferred by the aforesaid Act approved April 7, 1870. In and by the provisions of Section 5 of the Act of April 7, 1870, the capital of the Pennsylvania Company (and hence of the Excelsior Enterprise Company), was fixed at \$100,000., divided into 2,000 shares of \$50. each, "with the privilege of increasing same by a vote of the holders of a majority of the stock present at any annual or special meeting to such an amount as they may from time to time deem needful".

In and by a further act of the Legislature of the Commonwealth of Pennsylvania entitled "An Act Supplementary to an Act entitled 'An Act to Incorporate the Pennsylvania Company', approved the seventh day of

April, *Anno Domini* One thousand eight hundred and seventy, authorizing the issue of common or preferred stock and authorizing the sale or disposal thereof by the Company", approved February 18, 1871, it was provided that the capital stock of the Pennsylvania Company (and hence of the Excelsior Enterprise Company) or the stock thereof, when increased in the mode and manner described in said Act of April 7, 1870, could be in the whole common, or in part preferred stock, as the Company might from time to time determine and the Pennsylvania Company (and hence the Excelsior Enterprise Company), was authorized and empowered to issue said stock or any portion thereof in payment of any debt or liability incurred in the purchase of any property or to sell or dispose of any portion of common or preferred stock on such terms and conditions as the Company should agree upon with any party or parties, company or companies.

Thereafter and on January 18, 1873, pursuant to the power conferred by Section 9 of the Act of April 7, 1870, the name Excelsior Enterprise Company was by resolution of the Board of Directors, changed to The National Company, and thereafter by order dated December 7, 1896, of the Court of Common Pleas, No. 1, for the County of Philadelphia, September Term, 1896, No. 973, the name of The National Company was changed to Reading Company.

The Plan and Agreement of Reorganization dated December 14, 1895, authorized the Reorganization Managers thereunder, to adopt or use any existing or future companies for carrying out the same, and the Reorganization Managers employed the aforesaid Company which had become known as the Reading Company for the purposes of said reorganization and vested in said Company title to stocks and bonds of the Philadelphia and Reading Railway Company (hereinafter referred to as the Railway Company) and of the Coal Company.

Pursuant to the authority granted by the Acts afore-

said, and pursuant to the Plan and Agreement of Reorganization dated December 14, 1895, the stockholders of the Reading Company at a meeting duly held on December 18, 1896, adopted resolutions for the increase of the capital stock of the Company to the aggregate sum of \$140,000,000., divided into 2,800,000 shares of the par value of \$50. each, of which 560,000 shares of the aggregate par value of \$28,000,000. should be First Preferred Stock, 840,000 shares of the aggregate par value of \$42,000,000. should be Second Preferred Stock and the remainder, 1,400,000 shares of the aggregate par value of \$70,000,000. should be Common Stock, each share of stock being of a par value of \$50. A copy of said resolutions is attached hereto, made part hereof and marked Exhibit "A".

It was further provided in and by said resolutions that certificates for the First Preferred, Second Preferred and Common Stock of the Reading Company, should from time to time, be issued in such form as the Board of Directors should determine, and pursuant to such resolutions at a meeting of the Board of Directors of the Reading Company held December 23, 1896, the forms for the First Preferred Stock, Second Preferred Stock and Common Stock certificates were duly adopted. Copies of the forms of such certificates of stock are attached hereto, made part hereof and marked Exhibit "B".

Thereafter there were issued by the Reading Company pursuant to authority duly conferred by law and for valid consideration (and there are now outstanding), the shares of stock provided to be issued by the aforesaid resolutions, to wit: \$28,000,000. par value of First Preferred Stock; \$42,000,000. par value of Second Preferred Stock, and \$70,000,000. par value of Common Stock, and certificates representing the same were originally issued in the form set forth in Exhibit "B" hereto.

Thereafter and on September 14, 1904, the Board of Directors of the Reading Company adopted forms for

the certificates of First Preferred, Second Preferred and Common Stock of the Reading Company in conformity with the rules of the New York Stock Exchange and the Philadelphia Stock Exchange adopted since the form of the certificates (Exhibit "B" hereto) had been authorized, and copies of such new forms of certificates are attached hereto, made part hereof, and marked Exhibit "C". Thereafter only such new forms of certificates were issued as and when the old certificates were presented for transfer, and substantially all shares of the stock of the Reading Company are represented by certificates in the forms set forth in Exhibit "C".

6. Your petitioners are advised and believe, and they therefore aver, that by reason of the foregoing, the holders of the First and Second Preferred Stock of the Reading Company are entitled to non-cumulative dividends at the rate of, "*but not exceeding*" 4% in each and every fiscal year, *and no more*, and that they are entitled to said dividends in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock, but only from undivided net profits of the Company, when and as determined by the Board of Directors, and only if and when the Board shall so declare dividends therefrom, and that the Board may, after providing for the payment of "*full*" dividends as aforesaid for any fiscal year on the First and Second Preferred Stock, declare and pay *all* of the surplus undivided net profits for such year as a dividend upon the Common Stock; and that in the event that the undivided net profits of any fiscal year are greater than a sum sufficient to pay the aforesaid dividends of 4% on the First and Second Preferred Stock, the Board may at any time declare such excess (or any part remaining after the payment of such dividends as were declared upon the Common Stock) as a further dividend upon the Common Stock, and that such excess undivided net profits (or such remaining part), may

not be utilized for the declaration and payment of further dividends upon the First and Second Preferred Stock or for distribution to holders thereof, prior to the liquidation and dissolution of the Reading Company, except that no dividends may be declared and paid upon the Common Stock out of the net profits of any previous fiscal year unless and until the "full" dividends for such fiscal year, *to wit*, 4%, shall have been paid on the First and Second Preferred Stock.

7. Dividends of 4% per annum have been paid upon the First Preferred Stock at all times since the year 1900, except that for the years 1900 and 1902 only 3% was paid, and dividends of 4% per annum have been paid upon the Second Preferred Stock in each year since 1900 except that in the years 1900, 1901 and 1902 no dividends were paid thereon, and in the year 1903 only 1½% in dividends was paid thereon. No dividends were paid upon the Common Stock until 1905, when 3½% was paid thereon. Thereafter, for the years 1906 to 1909 inclusive 4% per annum was paid in dividends upon such Common Stock. For the years 1910, 1911 and 1912 6% per annum was paid thereon, and *for the years 1913 to 1920 inclusive 8% per annum was paid in dividends upon the Common Stock.*

8. Your petitioners are advised and believe and they therefore aver, that for the ten year period, 1910 to 1920, inclusive, dividends of *more than 4%* per annum have been declared and paid upon the Common Stock of the Reading Company; that such dividends were duly declared by its Board of Directors and the acts of the Board in declaring such dividends were ratified by the stockholders of the Reading Company at their annual meetings; that information with respect to the amount of dividends declared and paid upon the Common Stock was throughout this period published by the Reading Company in its annual

reports to stockholders, and knowledge of the amount of dividends paid upon such Common Stock was general throughout the community; that no protest against, criticism of or objection to the payment of such dividends was ever made by any preferred stockholder, bondholder, trustee under any mortgage, director or officer of the Reading Company, and your petitioners aver that all interests have acquiesced in the construction that the holders of the Common Stock are entitled to have declared and paid to them as dividends, the excess of undivided net profits for the fiscal year remaining, after provision had been made for the payment of "full" dividends of 4% per annum upon each of the First Preferred and Second Preferred Stock, and your petitioners further aver that the acquiescence in such construction constitutes likewise, acquiescence in the practical interpretation of the contract by all the parties concerned, that the holders of the Common Stock are entitled to have declared and paid to them as dividends, the excess undivided net profits for any fiscal year remaining, after payment of dividends upon the First and Second Preferred Stock, and upon the Common Stock, and which becomes part of the accumulated surplus of the Reading Company.

In or about the year 1905, and for all years thereafter to date, the Board of Directors of the Reading Company has set aside out of undivided profits for the particular fiscal year a sum sufficient to pay dividends of 4% in semi-annual or quarterly instalments upon the First Preferred Stock, before declaring or paying dividends upon the Second Preferred Stock and the Common Stock out of the undivided profits of such particular fiscal year; and after making such provision for dividends upon the First Preferred Stock, the Board of Directors has set aside out of the surplus earnings for such fiscal year, a sum sufficient to pay dividends of 4% per annum in semi-annual or quarterly instalments upon the Second Pre-

ferred Stock, before declaring or paying dividends upon the Common Stock of the Company out of the undivided profits of such fiscal year. After making such provision for dividends upon the First and Second Preferred Stock, the Board of Directors has declared dividends out of the remaining undivided profits for such fiscal year upon the Common Stock.

Attached hereto and made part hereof, marked "Exhibit D" is a copy of the resolutions adopted at the meeting of the Board of Directors held on December 28, 1920. Resolutions of the same character were adopted at meetings of the Board of Directors in each year since 1905. It is the practice of the Reading Company after setting aside sums sufficient to pay dividends upon the First and Second Preferred Stock, as hereinbefore set forth, from time to time to declare dividends upon the First and Second Preferred Stock out of the sums set aside as aforesaid, and there is attached hereto and made part hereof, marked "Exhibit E" an extract from the Minutes of the meeting of the Board of Directors held January 18, 1921, declaring such a dividend on the First Preferred Stock. Information with respect to the manner of declaring dividends and the setting aside of sums sufficient to make provision therefor, was published by the Reading Company in its annual reports to stockholders, and knowledge of the amount of dividends paid and the manner of providing therefor were general throughout the community, and no protest against, criticism of, or objection to, this manner of declaring and paying dividends was ever made.

9. It was provided in and by the Plan and Agreement of Reorganization dated December 14, 1895, that at any time after dividends at the rate of 4% per annum shall have been paid for two successive years on the First Preferred Stock, the Second Preferred Stock could be converted by the Reading Company, one-half into First

Preferred Stock and one-half into Common Stock, and provision was made for the increase in the amount of First Preferred Stock and Common Stock required by the exercise of such right of conversion. The resolutions creating such Second Preferred Stock ("Exhibit A" hereto), and the certificates representing such Second Preferred Stock, contain provisions for the right of the Reading Company so to convert Second Preferred Stock. All of the shares of capital stock of the Reading Company are entitled to vote, and until the aforesaid right of conversion is exercised, control of the Reading Company is equally divided between the Preferred and Common Stock (there being issued and outstanding \$70,000,000 par value of First and Second Preferred Stock and \$70,000,000 par value of Common Stock). The exercise of the aforesaid right of conversion, however, would leave outstanding \$49,000,000 par value of First Preferred Stock and \$91,000,000 par value of Common Stock and control of the management of the company would, thereupon, pass to the holders of the Common Stock.

In the resolutions creating the First Preferred Stock and Second Preferred Stock ("Exhibit A" hereto), it is provided

"But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock".

A similar provision is contained in the certificates of stock of the Reading Company (Exhibits "B and C" hereto).

No such provision appeared in the Plan and Agreement of Reorganization dated December 14, 1895, and your petitioners are advised and believe, and they therefore aver that such provision was inserted, because without it (as the dividends payable upon the Preferred Stock

were non-cumulative), the holders of the Common Stock who, upon conversion of the Second Preferred Stock, would obtain control of the management of the corporation, could refrain from declaring dividends upon the First Preferred Stock, and thus cause the undivided profits of a particular fiscal year, to become part of the accumulated surplus of the corporation, and subject at some future time to distribution among the holders of the Common Stock, to the exclusion of the holders of Preferred Stock, and your petitioners further aver that such provision was intended to make it impossible for the holders of Common Stock to profit at the expense of holders of Preferred Stock, by any exercise of control which would deprive the holders of Preferred Stock of dividends, when such action would inure to the benefit of the holders of Common Stock, and that such provision was in recognition and not in derogation of the right of the holders of Common Stock, to have the accumulated and undivided surplus of the Reading Company held subject to distribution solely among the holders of Common Stock by way of dividends.

10. As appears from the twenty-second annual report of the Reading Company for the fiscal year ended December 31, 1919, the profit and loss account of the Reading Company, upon its balance sheet as of December 31, 1919, shows a credit balance of \$33,201,149.81. Such credit balance to profit and loss, represents an accumulation of net earnings for particular fiscal years, after paying the dividends in such years. The amounts contributed to such accumulated surplus by the earnings of particular fiscal years, as appears from the annual reports of the Reading Company, are approximately as follows:

Year
ended
June 30

1897 (7 mos.)	—\$1,243,127
1898.....	1,376,420
1899.....	517,426
1900.....	577,217
1901.....	239,965
1902.....	—227,989
1903.....	1,023,248
1904.....	1,862,140
1905.....	2,181,857
1906.....	2,487,241
1907.....	2,724,153
1908.....	2,750,894
1909.....	3,342,726
1910.....	2,481,850
1911.....	1,248,963
1912.....	1,265,642
1913.....	2,227,836
1914.....	2,422,742
1915.....	143,722
1916.....	1,056,479

Year
ended
Dec. 31

1917 (18 mos.)	2,289,660
1918.....	1,809,970
1919.....	642,115

\$33,201,150

11. The Reading Company is the holder of all of the \$8,000,000 par value of the capital stock of the Coal Company, and the Coal Company is indebted to the Reading Company as appears from the balance sheet of the Reading Company as of December 31, 1919, in the sum of \$69,919,770.06. The same amount appears in the balance sheet of the Coal Company as being due to the Reading Company. Payments on account of interest have been made upon such indebtedness from time to time,

as appears from the annual reports of the Reading Company and of the Coal Company, and the amount now due to the Reading Company is the balance of an original indebtedness which has from time to time been diminished by various amounts, as likewise appears from said reports. The investment of the Reading Company with respect to the Coal Company, appears on the books of the Reading Company as of December 31, 1919, as follows:

Philadelphia & Reading Coal & Iron Company's stock	\$8,000,000.00
Due from Philadelphia & Reading Coal & Iron Company	69,918,770.06
Total	\$77,918,770.06

12. In and by the Plan dated February 14, 1921, submitted to this Honorable Court, it is provided, in Paragraph 3 thereof, that the Reading Company release the claim of approximately \$70,000,000 hereinbefore referred to, due from the Coal Company, and in Section 5 it is provided that the Coal Company be consolidated with the Delaware Coal Company, and the stock of the Consolidated Company (which stock is also hereinafter referred to as the stock of the Coal Company) be sold to the stockholders of the Reading Company for an amount equivalent to \$5,600,000; and in Section 2 of the Plan it is provided that the Coal Company pay to the Reading Company \$10,000,000 in cash or current assets at market value and \$25,000,000 in 4% Mortgage Bonds of the Coal Company. Hence your petitioners aver that in return for the investment standing upon the books of the Reading Company at \$77,919,770.06, the Reading Company is to receive the following:

Cash	\$10,000,000
Bonds	25,000,000
Cash for sale of stock	5,600,000
Total	\$40,600,000

Your petitioners aver that the result of carrying out the Plan will be to eliminate and to distribute the surplus aforesaid of \$33,201,150, representing the accumulation of net earnings of the Reading Company. As appears from the accounts of the Reading Company aforesaid, the value of the stock of the Coal Company to be distributed equally to the preferred and common stockholders upon payment of \$5,600,000 will be the difference between \$77,918,770.06 (*infra*, p. 14) and \$35,000,000, to wit, \$42,918,770.06. And your petitioners aver that the Plan, in affording holders of Preferred and Common Stock the right to purchase said stock of the Coal Company upon equal terms, violates the right of the holders of the Common Stock of the Reading Company to have said surplus, with the exceptions aforesaid, distributed solely to them, as the earnings of fiscal years to which the holders of Preferred Stock have no right, and which the Board of Directors of the Reading Company could have distributed at the close of each fiscal year solely to the holders of the Common Stock.

13. In addition to the surplus of \$33,201,150. appearing on the balance sheet of the Reading Company as of December 31, 1919, the Reading Company, through its ownership of the entire capital stock of the Coal Company, and of the entire capital stock of the Railway Company, is in equity the owner of the surpluses of the latter two companies accumulated out of net earnings of said Companies since the date when said Reading Company acquired their securities and became their sole stockholder.

14. As appears from the balance sheet in the annual report of the Coal Company for the fiscal year ending December 31, 1919, the Coal Company has a surplus of \$19,013,206, consisting of accumulated net earn-

ings of fiscal years subsequent to the year 1896, when the Reading Company acquired all the stock of the Coal Company. This also appears from the annual reports of the Coal Company, reference to which is hereby made for the details thereof; and the Reading Company would have been entitled to have such accumulated earnings represented by said surplus declared to it as a dividend, and such dividend would constitute earnings distributable to the holders of stock of the Reading Company according to their respective rights in the undistributed profits of the Reading Company as the same have been hereinabove set forth. The surplus of \$19,013,206 of the Coal Company is not reflected in the balance sheet of the Reading Company, but the Reading Company is equitably entitled to same, and if the properties of the Coal Company were sold for an amount equal to the value of its assets as they appear in the balance sheet of the Coal Company as of December 31, 1918, the sum representing said surplus and which would accrue to the Reading Company, would be a part of the surplus of the Reading Company and would be distributable in accordance with the respective rights of the holders of its Common and Preferred Stock as the same have been hereinbefore set forth.

15. The Reading Company is the owner of \$42,481,700 par value of the capital stock of the Railway Company, \$20,000,000 par value of which it acquired as the result of the reorganization aforesaid, and \$22,481,700 par value of which it acquired in return for amounts advanced to the Railway Company. The Reading Company is also the owner of \$20,000,000 principal amount of the bonds of the Railway Company. The investment of the Reading Company with respect to the Railway Company

appears in the balance sheet of the Reading Company as of December 31, 1919, as follows:

Philadelphia & Reading Railway Company's bonds	\$20,000,000
Philadelphia & Reading Railway Company's stock	42,481,700
Total	\$62,481,700

The Railway Company, as appears from its annual report for the fiscal year ending December 31, 1919, has a surplus of \$43,793,524.59, consisting of

Additions to property through income and surplus since June 30, 1907.	\$33,383,185.76
Profit and loss	10,410,338.83

As appears from the annual reports of the Railway Company, reference to which is hereby made for particulars, the said surplus represents accumulated earnings which could have been declared as dividends to the Reading Company, its sole stockholder, and by virtue of the ownership of all of the stock of the Railway Company the Reading Company is in equity entitled to the ownership of said surplus. Your petitioners aver that it would have been lawful to have made additions to property through the issuance of stock for cash, or by borrowing sums requisite therefor, and that the earnings which were employed for the acquisition of such additions to property could have been lawfully distributed to the holders of stock of the Railway Company as a dividend. Had such dividends been paid to the Reading Company the undistributed profits resulting therefrom would have been distributable to the holders of the Preferred and Common Stock of the Reading Company in accordance with their respective rights as the same have been hereinbefore set forth.

16. Your petitioners are advised and believe and they therefore aver, that if the properties of the Railway Company were sold for the price at which the properties are carried in the books of the Railway Company, and the purchase price distributed, the Reading Company, as its sole stockholder, would receive and carry the amount represented by the surplus of the Railway Company into its own surplus, which would be distributable to the holders of Preferred and Common Stock of the Reading Company in accordance with their respective rights, as the same have been hereinbefore set forth, as representing *profit* over and beyond the original investment of the Reading Company in the securities of the Railway Company.

17. Your petitioners are advised and believe, and they therefore aver, that if the accounts of the Reading Company were made to reflect the surpluses of the Coal Company and of the Railway Company, of which the Reading Company, by virtue of its ownership of all of the capital stock of such Companies, is in equity the owner, the surplus of the Reading Company would appear as follows:

Profit and Loss, Reading Company (December 31, 1919)	\$33,201,149.81
Profit and Loss Coal Company (December 31, 1919)	19,013,206.00
Additions to Property through Income—Railway Company (December 31, 1919)	33,383,185.76
Profit and Loss, Railway Company (December 31, 1919)	10,410,338.83
✓Total	<u>\$96,007,880.40</u>

Your petitioners further aver that if the Plan dated February 14, 1921, were carried out, the result thereof would be to diminish the aforesaid surplus by the sum of \$37,318,770.06 (*infra*, p. 14, to wit, \$77,918,770.06 less

\$40,600,000), and to distribute such sum equally to holders of Preferred and Common stock of the Reading Company, whereas in truth and in fact the holders of Common Stock of the Reading Company are entitled to all the benefits of or pertaining to said surplus with the exceptions hereinbefore set forth.

18. Your petitioners are advised that it is contended that the Reading Company can offset the loss of \$37,318,770.06 aforesaid arising out of the disposition of its interest in the Coal Company, by the surplus of \$43,793,524.59 of the Railway Company, acquired by merger of the Reading Company with the Railway Company, but your petitioners are advised and believe and therefore aver that the acquisition by the Reading Company of the surplus of the Railway Company will not be the acquisition of a new asset, but is property to which the holders of the Common Stock of the Reading Company are now equitably entitled. Such surplus will increase the surplus of the Reading Company, if said merger of the Reading Company with the Railway Company is effectuated prior to the distribution of the stock of the Coal Company. If the distribution of the stock of the Coal Company takes place prior to said merger, then the existing surplus of the Reading Company of \$33,201,150. will have been dissipated and a distribution of said surplus as hereinbefore set forth will in effect have been made equally to Preferred and Common Stockholders, *in violation* of the rights of the holders of the Common Stock.

Your petitioners are advised that it may be contended that the \$8,000,000 of stock of the Coal Company, after the release of the indebtedness of \$69,918,770.06 to the Reading Company and the payment to the Reading Company of \$10,000,000 in cash or current assets at market value, and \$25,000,000 principal amount of

bonds, will not be worth the sum of approximately \$42,918,770.06 as hereinbefore set forth.

Your petitioners aver that the stockholders of the Reading Company have little or no accurate information as to the value of the assets of the Coal Company, and no information has been published by the Reading Company or the Coal Company from which the value of such assets may be correctly ascertained. Your petitioners are advised and believe, and they therefore aver that all interests will best be served by having an appraisal made of the properties of the Coal Company to the end that reliable information may be obtained as to the value thereof, and that this Court may then determine the manner and mode of and rights in the distribution of the surplus of the Reading Company as represented by the interests of the Reading Company in the assets of the Coal Company.

19. It is further provided in and by the Plan dated February 14, 1921, in Paragraphs 4 and 5 thereof, that the properties of the Coal Company and its \$8,000,000 par value of capital stock, shall be released from the lien of the General Mortgage and the Coal Company shall be discharged from liability on the General Mortgage Bonds, and that to accomplish such result a *premium* of not exceeding 10% upon the principal amount of the outstanding General Mortgage Bonds be paid to the holders thereof by the Reading Company. To that end, it is provided that a Committee be organized to act in the interest of the bondholders, which said Committee shall call for the deposit of bonds, and which Committee shall be authorized by the depositors to carry out the operation in their behalf. Your petitioners are advised and believe, and they therefore aver, that the carrying out of such operation will involve an expenditure of approximately \$10,000,000 by the Reading Company; that the indebtedness of the Reading Company upon such General Mort-

gage Bonds will not be diminished by such payment, but that the Reading Company will still remain indebted in the same amount as at present to the holders of General Mortgage Bonds, who have ample security for the payment of such amount, even if the properties of the Coal Company and its capital stock shall have been released from the lien of said General Mortgage.

20. Your petitioners are advised and believe, and they therefore aver, that a segregation of the coal and railway properties of the Reading Company, pursuant to the Decree of Mandate entered herein, can be effected without prejudice to the rights of the United States of America, by permitting the General Mortgage to remain undisturbed and by providing for the making of such agreements with the Trustee under said General Mortgage as will render impossible any common control of the coal and railway properties, and your petitioners are advised and believe, and they therefore aver, that such plan can be effected without requiring the release of any property from the lien of said General Mortgage. Your petitioners aver that such result will be effectuated if an agreement is entered into with the Trustee of the General Mortgage which shall provide that in the event of default thereunder, separate receivers of the coal and railway properties (or their securities) be appointed if the Trustee should exercise its rights in that behalf; that the operation of such receivers shall be independent, that in the event that a sale be made of the properties of the Coal Company and the Railway Company (or their securities), separate sales be had thereof, to independent purchasers free from common domination and control; and that in the event the Trustee shall exercise any other powers under the General Mortgage, vesting it with the right to operate the properties of the Coal Company and of the Reading Company or to control their securities, such operation

or control shall provide for independent management and freedom from any community or identity of interests.

Your petitioners further aver that in order to carry out the segregation directed by the Decree of Mandate herein, the capital stock of the Coal Company need not be released from the General Mortgage. The General Mortgage provides that the Trustee thereunder promises to execute to the Reading Company, upon demand, proxies to vote the capital stock of the Coal Company, and this Honorable Court in order that said stock may be voted by persons free from domination or control of the Reading Company or the Railway Company may in a manner to be determined by this Honorable Court direct that the Reading Company shall instruct or empower the Trustee irrevocably to issue proxies from time to time to (a) persons designated or approved by this Honorable Court to exercise independent control of the Coal Company pending the acquisition of control by holders of Certificates of Interest, and (b) holders of Certificates of Interest in the capital stock of the Coal Company who shall at the time of applying for such proxies make affidavit that for such period as the Court shall direct, they have not been holders of capital stock of the Reading Company, and in order that such segregation may be complete this Honorable Court may require the Reading Company to adopt a by-law that it will register no transfers of shares of stock of the Reading Company into the names of persons who shall not make affidavit that they have not for such period as the Court shall direct, been holders of proxies to vote shares of stock of the Coal Company.

21. Your petitioners are advised and believe and they therefore aver that as the Reading Company is now the holder of the equity of redemption in the capital stock of the Coal Company held by the Trustee under the General Mortgage, this Honorable Court may direct that the

Reading Company shall assign such equity of redemption to its stockholders who shall receive Certificates of Interest in said stock which shall entitle the holder thereof to the dividends upon said stock and to a proxy to vote the same when he shall make the affidavit hereinabove set forth.

22. Your petitioners are advised and believe, and they therefore aver that arrangements can be made between the Reading Company and the Coal Company similar to those proposed in the Plan dated February 14, 1921, which will not require the release of any property from the lien of said General Mortgage. The Reading Company and the Coal Company may agree that the Coal Company shall pay to the Reading Company \$10,000,000. in cash or assets at current market value, and that the Coal Company shall obligate itself to pay principal and interest with respect to \$25,000,000. principal amount of General Mortgage Bonds, the Reading Company agreeing to hold the Coal Company and its properties harmless from any liability upon such General Mortgage Bonds or under the General Mortgage so long as the Coal Company shall meet such obligation under the agreement, the Coal Company to secure the Reading Company against any payments which the latter company may be compelled to make because of the default of the Coal Company under the agreement, or in lieu thereof it can be provided in the event of default of the Coal Company under the agreement aforesaid, that the Trustee under the General Mortgage shall at the request of the Reading Company proceed to a sale of the properties of the Coal Company to an independent purchaser approved by this Honorable Court and hold the proceeds under the provisions of the General Mortgage. With respect to the provisions of Section 10 of Article 2 of the General Mortgage, providing for a specified sinking fund equal to five cents per ton on coal mined, the Reading Company and the Coal Company may agree that

such sinking fund shall be paid by the Coal Company, and that there be applied against the obligation of the Coal Company to pay principal and interest with respect to \$25,000,000. principal amount of General Mortgage Bonds, the principal amount of General Mortgage Bonds purchased with such sinking fund, so that the Coal Company, by paying such sinking fund, will be relieved from paying principal and interest with respect to an amount of bonds equivalent to the amount purchased with such sinking fund.

23. Your petitioners beg leave to present the following suggestions for modifications of the Plan submitted to this Honorable Court:

I. The General Mortgage 4% Bonds and the General Mortgage under which they are issued shall remain undisturbed, except that provision shall be made under an agreement with the Trustee under said General Mortgage for separate receiverships of the coal properties and the railway properties (or their securities) in the event of default under the General Mortgage, and separate sales of the coal properties and the railway properties (or their securities) to independent purchasers, and in the event that the Trustee shall exercise the right to operate the properties or control the securities of the Coal Company and the Railway Company under any of the powers conferred upon it by the General Mortgage, such operation or control shall provide for independent management of the coal and railway properties (or their securities).

II. The Reading Company shall in a manner to be determined by this Honorable Court instruct or empower the Trustee under said General Mortgage irrevocably to issue proxies from time to time to vote the capital stock of the Coal Company to (a) persons designated or approved by this Honorable Court to exercise independent control of the Coal Company, pending the acquisition of control by holders of Certificates of Interest and (b) hold-

ers of Certificates of Interest in the capital stock of the Coal Company who shall, at the time of applying for such proxies, make affidavit for such period as the Court shall direct that they have not been holders of the capital stock of the Reading Company, and the Reading Company shall adopt a by-law that it will register no transfers of shares of stock of the Reading Company into the names of persons who shall not make affidavit that they have not for such period as the Court shall direct been holders of proxies to vote shares of stock of the Coal Company.

III. The Coal Company shall pay to the Reading Company \$10,000,000 in cash or assets at current market values and agree to pay principal and interest with respect to \$25,000,000 principal amount of General Mortgage Bonds, the Reading Company agreeing to hold the Coal Company and its properties harmless from any liability upon such General Mortgage so long as the Coal Company shall meet such obligation under the agreement, and the Coal Company shall secure the Reading Company for any payments which the latter Company may be compelled to make because of the default of the Coal Company under the agreement, or in lieu thereof it shall be provided that in the event of the default of the Coal Company under the agreement aforesaid, the Trustee under the General Mortgage shall, at the request of the Reading Company, proceed to a sale of the properties of the Coal Company to an independent purchaser approved by this Honorable Court. With respect to the provisions of Section 10 of Article 2 of the General Mortgage, providing for a specified sinking fund equal to five cents per ton on coal mined, the Reading Company and the Coal Company shall agree that such sinking fund shall be paid by the Coal Company, and that there be applied against the obligation of the Coal Company to pay principal and interest with respect to \$25,000,000 principal amount of General Mortgage Bonds, the principal amount of the General Mortgage Bonds purchased with such sinking fund, so that the Coal Company, by

paying such sinking fund, will be relieved from paying principal and interest with respect to an amount of bonds equivalent to the amount purchased with such sinking fund.

IV. The Reading Company shall assign its equity of redemption in the capital stock of the Coal Company and issue Certificates of Interest which will entitle the holder thereof to the earnings of said capital stock and its other rights and the right to vote the same when the required affidavit is made, such Certificates of Interest to be distributed to the present holders of the Capital Stock of the Reading Company upon equal terms, to the holders of Preferred and Common Stock, *only* in the event that this Honorable Court shall determine that holders of Preferred and Common Stock are entitled to equal distribution out of the accumulated surplus of the Reading Company. In the event, however, that this Honorable Court shall determine that the holders of Common Stock are, with the exceptions hereinbefore set forth, entitled to the accumulated surplus, an appraisal shall be had of the properties of the Coal Company and the value of the capital stock of the Coal Company determined, to the end that this Honorable Court may determine how much of the capital stock of the Coal Company, if any, shall be distributed in return for original capital of the Reading Company (in which event the capital stock of the Reading Company shall be reduced by that amount), and how much shall be distributed out of accumulated surplus, and this Honorable Court shall thereupon direct a distribution of Certificates of Interest to holders of the capital stock of the Reading Company on the basis thus determined.

WHEREFORE your petitioners respectfully pray that leave of this Honorable Court be granted them to intervene herein and that in the event this Honorable Court shall extend such leave to your petitioners, that this

petition stand as their petition of intervention, and that this Honorable Court modify the Plan dated February 14, 1921, now before it, in the manner hereinbefore suggested, or in such other manner as to this Honorable Court upon hearing and consideration shall seem just and equitable.

And your petitioners will ever pray, etc.

CONTINENTAL INSURANCE COMPANY,

by

HENRY EVANS,

Chairman of the Board of Directors.

FIDELITY-PHENIX FIRE INSURANCE COM-
PANY OF NEW YORK,

by

HENRY EVANS,

Chairman of the Board of Directors.

ALFRED A. COOK,

Solicitor for Petitioners,

Trinity Building,

New York City.

ALFRED A. COOK,

F. F. GREENMAN,

Of Counsel.

UNITED STATES OF AMERICA,
Southern District of New York, } ss.:
County and State of New York, }

HENRY EVANS being duly sworn, deposes and says, that he is the Chairman of the Board of Directors of Continental Insurance Company and Chairman of the Board of Directors of Fidelity-Phenix Fire Insurance Company of New York, the petitioners named in the foregoing petition; that he has read the foregoing petition and knows the contents thereof and the same is true to his best knowledge, information and belief.

Sworn to before me this }
March 12, 1921. }

HENRY EVANS.

FREDERICK G. BROWN,
Notary Public, Kings County
Certificate filed in New York County

[SEAL]

Exhibit A.

"RESOLVED, That the capital stock of the Reading Company be and it is hereby increased to the aggregate sum of \$140,000,000, divided into 2,800,000 shares, of the par value of \$50 each; of which 560,000 shares of the aggregate par value of \$28,000,000 shall be First Preferred Stock, and 840,000, of the aggregate par value of \$42,000,000 shall be Second Preferred Stock; and the remainder, 1,400,000 shares, of the aggregate par value of \$70,000,000 shall be Common Stock; and that the preferences of the First Preferred Stock, and of the Second Preferred Stock, shall be severally and respectively as follows:

"The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four

per cent per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

"Such First Preferred Stock is authorized to the amount of Twenty-eight million dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding, given at a meeting of the Stockholders called for that purpose, is necessary to any increase of such authorized amount thereof as well as to the creation of any mortgage additional to that for \$135,000,000 hereafter to be issued to acquire certain assets, real, personal and mixed, from Messrs. Coster and Stetson; except that, at any time after dividends at the rate of four per cent per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased, without such consent,

to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and, accordingly this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may so increase and issue its First Preferred Stock.

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

"The Second Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

"Such Second Preferred Stock is authorized to the amount of Forty-two million dollars, and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, or of the First Preferred Stock, as well as to the creation of any mortgage addi-

tional to the mortgage of \$135,000,000 hereinbefore referred to.

"The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of 4 per cent per annum shall have been paid for two successive years on the First Preferred Stock, the Reading Company, without further consent from the holder or owners hereof, may exercise the right to convert the Second Preferred Stock, not exceeding \$42,000,000 at par, one half into First Preferred Stock and one half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock.

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding according to the preferences thereof.

"Resolved, That when and as provided and reserved in the preferences of the First Preferred Stock and Second Preferred Stock, respectively, the Second Preferred Stock, to the aggregate par value not exceeding \$42,000,000, may be converted, one half into First Preferred Stock and one half into Common Stock, and that for that purpose the Reading Company may so increase and issue its First Preferred Stock and its Common Stock.

"Resolved, That the certificates for such First Preferred, Second Preferred and Common Stock of this Company shall from time to time be issued in such form as the Board of Directors may determine.

(Copy of resolution adopted at a special meeting of the stockholders of Reading Company held December 18, 1896.)"

Exhibit B.

TOTAL PRESENT ISSUE OF FIRST PREFERRED STOCK,
\$28,000,000.

No. Shares.

READING COMPANY.

First Preferred Stock. Shares \$50. Each.

THIS IS TO CERTIFY, that
is the owner of fully-paid and
non-assessable shares, of the par value of Fifty Dollars
each, of the FIRST PREFERRED CAPITAL STOCK of the
READING COMPANY, transferable only in person, or by
attorney, on the books of the Company in New York
upon surrender of this certificate.

The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividends on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

Such First Preferred Stock is authorized to the amount of twenty-eight million dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, as well as to the creation of any mortgage additional to that for \$135,000,000 heretofore authorized, except that, at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased: without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and, accordingly, this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may so increase and issue its First Preferred Stock.

The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant Secretary, of the Reading Company, nor until registered by the Registrar of Transfers in New York.

This certificate may be exchanged, in such manner as the Company may prescribe, for a similar certificate similarly signed, but registered by the Registrar of Transfers of the Company in Philadelphia.

ENTERED

.....
Transfer Agent

Registered in New York.
CENTRAL TRUST COMPANY
OF NEW YORK,
Registrar of Transfers.

By

.....

IN WITNESS WHEREOF, The
said Company has caused
this certificate to be
signed, and the corporate
seal to be affixed hereto,
this day of 1

.....
President.

.....
Secretary.

TOTAL PRESENT ISSUE OF SECOND PREFERRED STOCK,
\$42,000,000.

No. Shares

READING COMPANY

Second Preferred Stock. Shares, \$50. Each.

THIS IS TO CERTIFY, That

is the owner of fully paid
and non-assessable shares, of the par value of Fifty
Dollars each, in the SECOND PREFERRED CAPITAL STOCK
of the READING COMPANY, transferable only in person, or
by attorney, on the books of the Company in New York
upon surrender of this certificate.

The Second Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock: but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

Such Second Preferred Stock is authorized to the amount of forty-two million dollars; and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, or of the First Preferred

Stock, as well as to the creation of any mortgage additional to the mortgage of \$135,000,000 heretofore authorized.

The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of four per cent. per annum shall have been paid for two successive years on the First Preferred Stock, the Reading Company, without further consent from the holder or owner hereof, may exercise the right to convert the Second Preferred Stock, not exceeding \$42,000,000. at par, one half into First Preferred Stock and one half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock.

The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding, according to the preferences thereof.

This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant Secretary, of the Reading Company, nor until registered by the Registrar of Transfers in New York.

This certificate may be exchanged, in such manner as the Company may prescribe, for a similar certificate similarly signed, but registered by the Registrar of Transfers of the Company in Philadelphia.

ENTERED

.....
Transfer Agent

Registered in New York.
CENTRAL TRUST COMPANY
OF NEW YORK,
Registrar of Transfers.

By
.....

IN WITNESS WHEREOF, The
said Company has caused
this certificate to be
signed and the corporate
seal to be affixed hereto,
this day of 1

.....
President.

.....
Secretary.

TOTAL PRESENT ISSUE OF COMMON STOCK, \$70,000,000.

No. Shares.

READING COMPANY.

Common Stock. Shares \$50 each.

THIS IS TO CERTIFY, That
is the owner of fully paid
non-assessable shares, of the par value of Fifty Dollars
each, in the COMMON CAPITAL STOCK of the READING
COMPANY, transferable only in person, or by attorney, on
the books of the Company in New York upon surrender
of this certificate.

First Preferred Stock has been authorized to the
amount of twenty-eight million dollars, and Second Preferred
Stock to the amount of forty-two million dollars;
and a Mortgage has been authorized to the amount of
\$135,000,000., and the consent of the holders of at least
a majority of such part of the Common Stock as shall
be represented at a meeting of stockholders called for
that purpose is necessary to any increase of such authorized
amount of First Preferred Stock or Second Preferred
Stock, as well as to the creation of any additional mortgage;
provided, that without further consent, at any time
after dividends at the rate of four per cent. per annum
shall have been paid on the First Preferred Stock for
two successive years, the Second Preferred Stock, not
exceeding \$42,000,000., may be converted at par, one half
into First Preferred Stock and one half into Common
Stock, and that for such purchase and to such extent
the Reading Company may increase and issue its First
Preferred Stock and its Common Stock.

The Reading Company shall have the right at any time
to redeem either or both classes of its Preferred Stock, at
par in cash, if such redemption shall then be allowed by
law. The Common Stock is subject to the prior rights of
holders of all classes of Preferred Stock at any time outstanding,
according to the preferences thereof.

If, from the business of any particular fiscal year, excluding
undivided net profits remaining from previous years, after providing
out of the net profits of such particular year for the payment of
the full dividends for such fiscal year on the First and Second
Preferred Stock,

there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant Secretary, of the Reading Company, nor until registered by the Registrar of Transfers in New York.

This certificate may be exchanged, in such manner as the Company may prescribe, for a similar certificate similarly signed, but registered by the Registrar of Transfers of the Company in Philadelphia.

ENTERED:

.....
Transfer Agent.

Registered in New York.
CENTRAL TRUST COMPANY
OF NEW YORK,
Registrar of Transfers,

By

.....

IN WITNESS WHEREOF, The
said Company has caused
this certificate to be
signed, and the corporate
seal to be affixed hereto,
this day of 1

.....
President.

.....
Secretary.

Exhibit C

100 SHARES	FIRST PREFERRED STOCK	100 SHARES
NUMBER		SHARES 100

READING COMPANY

TOTAL PRESENT ISSUE OF FIRST PREFERRED STOCK
\$28,000,000..

THIS IS TO CERTIFY that

....the owner of ONE HUNDRED fully paid and non-assessable shares of the par value of FIFTY DOLLARS each of the FIRST PREFERRED CAPITAL STOCK of the READING COMPANY, transferable only in person, or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding four per cent per annum in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors and only if and when the Board shall declare dividends therefrom. If after providing for the payment of full dividends for any fiscal year on the First Preferred Stock there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

Such First Preferred Stock is authorized to the amount of twenty-eight million dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof as well as to the creation of any mortgage additional to that for \$135,000,000. heretofore authorized, except that at any time after dividends at the rate of four per cent per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased without such consent to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and, accordingly, this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may increase and issue its First Preferred Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary or Assistant Secretary of the Reading Company, nor until registered by the Registrar of Transfers in Philadelphia or New York. This certificate is transferable either in Philadelphia or New York.

ENTERED

Transfer Agent.

Registered in Philadelphia,
PENNSYLVANIA COMPANY
FOR INSURANCES, ON
LIVES AND GRANTING
ANNUITIES,

Registrar of Transfers.

By

.....

Registrar.

SHARES \$50 EACH.

(on face)

FIRST PREFERRED.

IN WITNESS WHEREOF, the
said Company has caused
this certificate to be
signed and the corporate
seal to be affixed hereto,
this day of .

.....

Vice-President.

.....

Assistant Secretary.

—

SECOND PREFERRED STOCK

100		100
SHARES		SHARES
	NUMBER	SHARES
		100

READING COMPANY

TOTAL PRESENT ISSUE OF SECOND PREFERRED STOCK,
\$42,000,000.

THIS IS TO CERTIFY that

....the owner of ONE HUNDRED fully paid and non-assessable shares, of the par value of FIFTY DOLLARS each, in the SECOND PREFERRED CAPITAL STOCK of the READING COMPANY, transferable only in person or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. The Second Preferred Stock is entitled to non-cumulative dividends, at the rate of, but not exceeding, four per cent per annum, in each and every fiscal year in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock. Such Second Preferred Stock is authorized to the amount of forty-two million dollars; and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such au-

thorized amount thereof or of the First Preferred Stock, as well as to the creation of any mortgage additional to the mortgage of \$135,000,000. heretofore authorized. The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of four per cent per annum shall have been paid for two successive years on the First Preferred Stock, the Reading Company without further consent from the holder or owner hereof, may exercise the right to convert the Second Preferred Stock, not exceeding \$42,000,000. at par, one half into First Preferred Stock and one half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding according to the preferences thereof. This certificate shall not be valid until signed by the President or one of the Vice-Presidents, and the Secretary or Assistant Secretary of the Reading Company, nor until registered by the Registrar of Transfers in Philadelphia or New York. This certificate is transferable either in Philadelphia or New York.

ENTERED

Transfer Agent.

Registered in Philadelphia,
PENNSYLVANIA COMPANY
FOR INSURANCES, ON
LIVES AND GRANTING
ANNUITIES,

Registrar of Transfers.

By

.....
Registrar.

SHARES \$50 EACH.

(on face)

SECOND PREFERRED.

IN WITNESS WHEREOF, the
said Company has caused
this certificate to be
signed and the corporate
seal to be affixed hereto,
this day of

.....
Vice-President.

.....
Asst. Secretary.

COMMON STOCK.

100			100
SHARES			SHARES
	NUMBER	SHARES	
		100	

READING COMPANY

TOTAL PRESENT ISSUE OF COMMON STOCK \$70,000,000.

THIS IS TO CERTIFY that

. . . the owner of ONE HUNDRED fully paid and non-assessable shares, of the par value of FIFTY DOLLARS each, in the COMMON CAPITAL STOCK of the READING COMPANY, transferable only in person or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. First Preferred Stock has been authorized to the amount of twenty-eight million dollars, and Second Preferred Stock to the amount of forty-two million dollars; and a Mortgage has been authorized to the amount of \$135,000,000., and the consent of the holders of at least a majority of such part of the Common Stock as shall be represented at a meeting of stockholders called for that purpose is necessary to any increase of such authorized amount of First Preferred Stock or Second Preferred Stock, as well as to the creation of any additional mortgage; provided, that without further consent at any time after dividends at the rate of four per cent per annum shall have been paid on the First Preferred Stock for two successive years, the Second Preferred Stock, not exceeding \$42,000,000. may be converted at par, one half into First Preferred Stock and one half into Common Stock and that for such purpose and to such extent the Reading Company may increase and issue its First Preferred Stock and its Common Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. The Common Stock is subject to the prior rights of holders of all classes of Preferred Stock at any time outstanding, according to the preferences thereof. If from the business of any particular

fiscal year, excluding undivided net profits remaining from previous years after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock; this certificate shall not be valid until signed by the President or one of the Vice-Presidents, and the Secretary or Assistant Secretary of the Reading Company nor until countersigned by the Transfer Agent and the Registrar.

This certificate is transferable either in Philadelphia or New York.

COUNTERSIGNED

Transfer Agent.

Registered

PENNSYLVANIA COMPANY
FOR INSURANCES, ON
LIVES AND GRANTING
ANNUITIES,

Registrar.

By

.....
Registrar.

SHARES \$50 EACH
(on face)
COMMON STOCK

IN WITNESS WHEREOF, The
said Company has caused
this certificate to be
signed and the corporate
seal to be affixed hereto,
this day of .

.....
Vice-President.

.....
Asst. Secretary.

Exhibit D.

EXTRACT FROM MINUTES OF MEETING OF BOARD OF
DIRECTORS OF READING COMPANY HELD DEC. 8, 1920.

"On motion, duly seconded, the following minute was adopted:

"Resolved, that the sum of \$1,120,000 of the surplus earnings for the fiscal year ending December 31, 1920, be and is hereby set apart to make provision for the following dividends upon the First Preferred Stock of this Company:

1% payable March 10, 1921, to stockholders of record at the close of business on February 18, 1921.

1% payable June 9, 1921, to stockholder of record at the close of business on May 24, 1921.

1% payable September 8, 1921, to stockholder of record at the close of business on August 23, 1921.

1% payable December 8, 1921, to stockholder of record at the close of business on November 22, 1921.

"WHEREAS, provision has been made for the payment from the earnings for the fiscal year ending December 31, 1920, of full dividends on the First Preferred Stock of the Company; therefore,

"Resolved, that a dividend of one per cent. be and is hereby declared upon the Second Preferred Stock of this Company, payable January 13, 1921, to stockholders of record at the close of business on December 23, 1920.

"Resolved, that the sum of \$1,260,000 of the undivided net profits of the Company for the fiscal year ending December 31, 1920, be and is hereby set apart to make provision for the following additional dividends upon the Second Preferred Stock of this Company:

1% payable April 14, 1921, to stockholders of record at the close of business on March 28, 1921.

1% payable July 14, 1921, to stockholders of record at the close of business on June 27, 1921.

1% payable October 13, 1921, to stockholders of record at the close of business on September 27, 1921.

"WHEREAS, after providing out of the net profits of the fiscal year ending December 31, 1920, for the payment of full dividends from the earnings for that fiscal year on the First Preferred and Second Preferred Stocks of the Company, there remain surplus net profits of said year; therefore,

"Resolved, that a dividend of two per cent. be and is hereby declared upon the Common Stock of the Company out of the remaining surplus net profits of the Company for the fiscal year ending December 31, 1920, payable on February 10, 1921, to stockholders of record at the close of business on January 18, 1921."

Exhibit E.

EXTRACT FROM MINUTES OF MEETING OF BOARD OF
DIRECTORS OF READING COMPANY HELD JANUARY 18,
1921.

"On motion, duly seconded, the following minate was adopted:

"WHEREAS, by a resolution adopted by the Board of Directors on December 8, 1920, the sum of \$280,000 of the undivided net profits of the Company for the fiscal year ended December 31, 1920, was set apart to make provision for a dividend of one per cent, upon the First Preferred Stock of this Company, payable on March 10, 1921, to stockholders of record at the close of business on February 18, 1921; therefore

"Resolved, that a dividend of one per cent. be and the same is hereby declared upon the First Preferred Stock of this Company, payable out of the net profits of the Company for the fiscal year ended December 31, 1920, on March 10, 1921, to the stockholders of record at the close of business on February 18, 1921."

**Petition of Seward Prosser, Mortimer N. Buckner and John H. Mason
as a Committee for Leave to Intervene on Behalf of Certain
Common Stockholders, and Suggesting Modification of Plan of
Dissolution.**

(Filed March 15, 1921.)

**TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
OF THE UNITED STATES, FOR THE EASTERN DISTRICT OF
PENNSYLVANIA.**

Now come your petitioners SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee formed at the request of certain holders of common stock of the defendant Reading Company, and respectfully represent unto this Court as follows:

I. That decree on mandate from the Supreme Court was entered herein by this Court and filed October 8, 1920, providing, among other provisions, for the submission to this Court of a plan for the dissolution of the unlawful combination between the defendants Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey and The Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other properties of the various Companies held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other of said four defendants other than the Reading Company, to the end that the affairs of all such defendant companies may be conducted in harmony with the law.

That on information and belief, thereafter and on February 14, 1921, a plan was submitted to this Court by said defendants Reading Company, Philadelphia & Reading Railway Company and The Philadelphia & Reading

Coal & Iron Company, providing in part for the carrying out of such decree in the aforesaid particulars, and that thereafter the United States of America presented a counter-proposal and that this Court thereupon entered an order requiring said plan and such counter-proposal of the United States of America to be served upon certain parties in interest other than your petitioners or any common stockholders, and that copies of said plan and counter-proposal be filed in the office of the Clerk of this Court and with the Secretary of the defendant Reading Company, there to be open to the inspection of all stockholders of said defendant companies, and that on March 1, 1921, the Attorney General of the United States and counsel for the defendants should appear to be heard further on said proposed plan and in regard to the subject matter thereof.

II. That thereafter under date of February 14, 1921, defendant Reading Company, by order of its Board of Directors, caused to be sent to its stockholders a notice of the submission of such plan, with the enclosure of a copy thereof and of said counter-proposal and of said order, which notice stated that said Board of Directors believed said plan involved a minimum disturbance of existing securities and permitted the stockholders of the Reading Company, preferred and common, to have an opportunity to participate ratably in the purchase of the Coal Company stock, retaining their interest unaltered in the remaining properties.

III. That your petitioners are a Committee formed at the request of certain holders of the common stock of said defendant Reading Company for the purpose of examining said plan and representing and protecting the interests of such stockholders in connection therewith, and that all of the property in which your petitioners as such Committee are interested is in the control and juris-

diction of this Court, in that the method by which the defendant Reading Company shall divest itself of all interests in the defendant The Philadelphia & Reading Coal & Iron Company involves the inter-relations between the holders of the preferred and of the common stock of the defendant Reading Company in connection with the distribution of such property or the proceeds thereof and rests in the discretion of this Court.

IV. On information and belief, that an appeal to the defendant Reading Company or its Board of Directors for a modification of said proposed plan in the interests of your petitioners and the holders of the common stock of said Company, would be a fruitless and vain form for the reason that, as appears by said notice transmitted to the stockholders of the Reading Company, such plan has been approved by said Board and in the opinion of said Board provides for the retention by the holders of both the common and preferred stocks of the Reading Company of their interests unaltered in the properties remaining with that Company.

V. On information and belief, that the interests of your petitioners and of the holders of the common stock of the Reading Company have, in the formulation of said plan, been overlooked and neglected by the Board of Directors of defendant Reading Company, as hereinafter more particularly shown.

VI. On information and belief, that the effect of the carrying out of said plan is to distribute to the preferred stockholders ratably per share with the common stockholders, a surplus of upwards of \$33,000,000 accumulated by the defendant Reading Company from the undivided net profits arising from its business, whereas in fact and in law and in compliance with the contract between the holders of the First and Second Preferred Stocks of said

Company and the holders of the Common Stock thereof, in relation to the interests of said several classes of stock in the assets and profits of said Company, all of such surplus, with the exception of a small part thereof which might possibly be claimed by the holders of said preferred stocks for dividends during the years in which it was earned and in which dividends on such preferred stocks were not fully paid, belongs under the circumstances here obtaining to the holders of the common stock of said Company, to the exclusion of the holders of both of said classes of preferred stock.

VII. That such situation is brought about by the equal distribution per share to the holders of all classes of stock of assets of the Reading Company in value more than twice (as appears on the statements of the Company) the amount of such surplus, and the recoupment or restoration of the capital of the Reading Company in part by the absorption and elimination of said surplus, and in part by the consideration to be paid by defendant Coal and Iron Company and the nominal so-called purchase price to be paid for the Coal and Iron Company stock, and that such situation becomes important to the holders of the common stock in that such existing surplus of the Company is, under the terms of the contract existing between the various classes of stock, available for dividends solely for the benefit of the holders of the common stock.

VIII. That inasmuch as the Reading Company is obliged under the decree of the Court to divest itself of said assets and under said plan receives therefor considerations which fall short of the value of said assets by an amount approximating said surplus, it appears to be necessary either to eliminate such surplus or to reduce the capital stock. That in order to obviate such inequity arising under said plan, your petitioners respectfully suggest a modification thereof by the addition to paragraph 5 thereof of the following:

"Coincidentally with the issuance and distribution of the certificates of interest in the Coal Company stock, as aforesaid, the Reading Company will reduce its capital stock by the amount of \$....., such reduction to apply to all shares of the stock of the Reading Company equally, regardless of classification into preferred and common, and such reduction to be effected by decree of the Court directing it should the Court accept this plan and so decree.

"For the purposes of carrying out such a provision, jurisdiction of the case shall be retained by the Court."

IX. That on information and belief, the aforesaid suggestion will not affect the interests of the United States of America, petitioner in this suit, and that if such plan should be so modified it will in all respects, so far as such change affects the matter, bring about a situation in full compliance with the requirements of the Supreme Court.

WHEREFORE, your petitioners respectfully pray that an order may be entered in this cause, granting unto your petitioners as a Committee as aforesaid, leave to file this petition and that the plan of dissolution now before this Court may be modified in the manner hereinbefore suggested, and your petitioners will ever pray, etc.

SEWARD PROSSER,

MORTIMER N. BUCKNER and

JOHN H. MASON,

As a Committee representing Holders
of Common Stock of the Defendant
Reading Company,

By SEWARD PROSSER,

Chairman.

WHITE & CASE,

Counsel for Petitioners,

14 Wall Street,

New York City.

J. DUPRATT WHITE,

Solicitor.

STATE OF NEW YORK, }
 County of New York, } ss:

SEWARD PROSSER, being duly sworn, says that he is one of the petitioners named in the foregoing petition and is Chairman of the Committee therein named; that he has read the foregoing petition and knows the contents thereof and that the same is true according to his best knowledge, information and belief.

SEWARD PROSSER.

Sworn to before me this 28th }
 day of February, 1921. }

ALLEN McCARTY,

Notary Public, Queens County,

Certificate filed in New York County,

Term expires March 30, 1922.

Amended and Supplemental Petition of Seward Prosser, Mortimer N. Buckner and John H. Mason as a Committee representing Holders of Common Stock for Modification of Plan of Dissolution.

(Filed March 15, 1921.)

TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
 OF THE UNITED STATES, FOR THE EASTERN DISTRICT
 OF PENNSYLVANIA.

Now come your petitioners, SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee formed at the request of certain holders of common stock of defendant Reading Company, who respectfully represent unto this Court as follows (the allegations other than in paragraphs I and XI being on information and belief) :

I. That your petitioners are a Committee formed at the request of certain holders of the common stock of

defendant Reading Company and as such now hold proxies from such stockholders representing upwards of 450,000 shares of such stock of the par value of \$22,500,000 and a present market value of upwards of \$30,000,000.

II. That at the hearing before this Court at Philadelphia on March 1, 1921, pursuant to order heretofore made herein by this Court, your petitioners presented their petition for leave to intervene herein on behalf of the common stockholders whom they represent and suggesting modification of the plan of dissolution, and were by oral order of this Court thereupon made granted such leave to intervene and did thereupon file their said petition.

That this Court by like oral order thereupon granted to parties in interest leave to file other petitions and suggestions in aid of the plan of dissolution. Pursuant thereto, your petitioners, intervenors, present this, their Amended and Supplemental Petition for modification of said plan of dissolution.

III. That defendant Reading Company was incorporated by Chapter 983 of the laws of Pennsylvania of 1871, as Excelsior Enterprise Co. It is a proprietary and not an operating company. It has an authorized and outstanding capital stock of \$140,000,000, divided into shares of \$50 par value, consisting of \$28,000,000 first preferred stock, \$42,000,000 second preferred stock and \$70,000,000 common stock.

IV. That the contract between the preferred and common stockholders in reference to their respective rights in connection with the assets and profits of said Company, provides in substance that the first and second preferred stock is entitled to non-cumulative dividends at the rate of,

but not exceeding, four per cent. (4%) per annum in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on the common stock; but only from undivided net profits of the Company when and as such undivided net profits shall have been determined by the Board of Directors and only if and when the Board shall declare dividends therefrom. That if, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the first and second preferred stock, there shall remain surplus net profits, the Board of Directors may declare and out of such surplus net profits of such year may pay dividends upon any other stock of the Company. But no dividends shall in any year be paid on any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the first and second preferred stock. That the Reading Company reserves the right at any time, after dividends at the rate of 4% shall have been paid for two successive years on the first preferred stock, without further consent from the holder or owner of the second preferred stock, to convert the second preferred stock into one-half first preferred stock and one-half common stock and, accordingly, so to increase and issue first preferred stock and common stock to provide for such conversion, and, further, that said Reading Company has the right at any time to redeem either or both classes of its preferred stock at par in cash, if such redemption shall then be allowed by law. That copies of the certificates representing first preferred, second preferred and common stock of said Reading Company are hereto annexed, marked "Exhibit A", and made part hereof.

That defendant Reading Company has paid dividends on its said first preferred stock as follows: 3% in the year

1900, 4% in the year 1901, 3% in the year 1902 and 4% per annum thereafter and down to this date.

That defendant Reading Company has paid dividends on its said second preferred stock as follows: 1½% in the year 1903 and 4% per annum thereafter and down to this date.

That defendant Reading Company has paid dividends on its said common stock of varying amounts, from 1½% on February 1, 1905, to 6% in each of the years 1911 and 1912, and that on February 13, 1913, it paid a quarterly dividend of 2% on said common stock, thereby putting such stock on an 8% basis, and thereafter and down to this date has paid quarterly dividends of 2%, or 8% per annum, on said common stock.

V. That in the last published balance sheet of defendant Reading Company, being the balance sheet as of December 31, 1919, the following assets appear:

Philadelphia & Reading Railway Company's stock.....	\$42,481,700.
The Philadelphia & Reading Coal & Iron Company's stock.....	8,000,000.
The Philadelphia & Reading Coal & Iron Company	69,919,770.06

That in said balance sheet the following liabilities appear:

First preferred stock.....	\$28,000,000.
Second preferred stock.....	42,000,000.
Common stock	70,000,000.
Profit and loss.....	33,201,149.81

That a copy of said balance sheet is hereto annexed, marked "Exhibit B", and made part hereof.

VI. That in the last published balance sheet of defendant The Philadelphia & Reading Coal & Iron Com-

pany, being the balance sheet as of December 31, 1919, there appears the following liabilities:

Capital Stock	\$8,000,000.
Reading Company	69,919,770.

That a copy of said balance sheet is hereto annexed, marked "Exhibit C", and made part hereof.

VII. That said item of debt from the Philadelphia & Reading Coal & Iron Company to Reading Company has not remained constant, but has varied from time to time. In the balance sheet of the Reading Company as of December 1, 1896, it was \$68,154,678.99.

In the balance sheets of the Reading Company as of the dates shown below, respectively, said item of debt appeared in the following amounts:

June 30, 1897.....	\$76,004,062.37
June 30, 1898.....	77,108,652.15
June 30, 1899.....	77,280,349.13
June 30, 1900.....	78,653,349.13
June 30, 1901.....	78,798,653.83
June 30, 1902.....	79,002,720.56
June 30, 1903.....	79,116,720.56
June 30, 1904.....	79,123,888.25
June 30, 1905.....	79,135,760.58
June 30, 1906.....	79,165,226.43
June 30, 1907.....	79,195,702.63
June 30, 1908.....	75,241,269.83
June 30, 1909.....	74,800,254.83
June 30, 1910.....	75,395,786.83
June 30, 1911.....	74,423,817.42
June 30, 1912.....	73,466,529.72
June 30, 1913.....	72,980,171.62
June 30, 1914.....	72,472,767.37
June 30, 1915.....	72,022,371.37
June 30, 1916.....	71,603,134.92
December 31, 1917.....	71,122,948.66
December 31, 1918.....	70,514,388.16
December 31, 1919.....	69,919,770.06

That during the years ended June 30th as shown below The Philadelphia & Reading Coal & Iron Company paid or credited to the Reading Company in respect of interest upon said item of debt the following sums:

June 30, 1900.....	\$884,850.18
June 30, 1901.....	886,504.62
June 30, 1902.....	888,780.61
June 30, 1903.....	1,582,334.41
June 30, 1904.....	1,582,477.77
June 30, 1905.....	1,582,255.21
June 30, 1906.....	1,583,304.53
June 30, 1907.....	1,583,914.05
June 30, 1908.....	1,584,485.40
June 30, 1909.....	935,003.19
June 30, 1910.....	743,957.87
June 30, 1911.....	320,000.00
June 30, 1912.....	810,998.97
June 30, 1913.....	2,269,405.15

That on page 5 of the third annual report of the Reading Company for the fiscal year ended June 30, 1900, the following appears:

“Note.—Interest upon the debt of The Philadelphia and Reading Coal and Iron Company to the Reading Company is only payable when earned.”

VIII. That in the last published balance sheet of defendant Philadelphia & Reading Railway Company, being the balance sheet as of December 31, 1919, there appear among its liabilities:

Capital Stock.....	\$42,481,700.
Additions to property through income and surplus since June 30, 1907.	33,383,186.
Profit and loss.....	10,410,339.

That a copy of said balance sheet is hereto annexed, marked “Exhibit D”, and made part hereof.

IX. That the effect of the carrying out of said plan is to distribute to the preferred stockholders ratably per share with the common stockholders, a surplus of upwards of \$33,000,000 accumulated by the defendant Reading Company from the undivided net profits arising from its business, whereas in fact and in law and in compliance with the contract between the holders of the First and Second Preferred Stocks of said Company and the holders of the Common Stock thereof, in relation to the interests of said several classes of stock in the assets and profits of said Company, all of such surplus, with the exception of a small part thereof which the holders of said preferred stocks might assert could not be distributed to the common stock because dividends during the years in which it was earned were not fully paid on such preferred stocks, belongs under the circumstances here obtaining to the holders of the common stock of said Company, to the exclusion of the holders of both of said classes of preferred stock.

X. That such situation is brought about under said plan by the equal distribution per share to the holders of all classes of stock of assets of the Reading Company in value more than twice (as appears on the statements of the Company) the amount of such surplus, and the recoupment or restoration of the capital of the Reading Company in part by the absorption and elimination of said surplus, and in part by the consideration to be paid by defendant Coal and Iron Company and the nominal so-called purchase price to be paid for the Coal and Iron Company stock, and that such situation becomes important to the holders of the common stock in that such existing surplus of the Company is, under the terms of the contract existing between the various classes of stock, available for dividends solely for the benefit of the holders of the common stock.

XI. That it is not material as affecting or changing the interests of the holders of the common stock of the defendant Reading Company whether the several steps of said plan are carried through in the order in which stated in said plan as presented to this Court, or whether said steps are carried through in some other order, as by first a merger between the Reading Company and the Philadelphia & Reading Railway Company and then a distribution of the assets of the Reading Company made up of its holdings of the stock and debt of the Coal Company, or by first the distribution of such assets of the Reading Company and thereafter a merger between the Reading Company and the Railway Company, because in either event the result will be, if said plan is carried out as proposed, to eliminate the surplus of the Reading Company as it now exists or to reduce the surplus of the Reading Company, as it will exist after the merging of the Reading Company and the Philadelphia & Reading Railway Company, by an amount substantially the same as the existing surplus.

XII. That under the contract between the holders of the first and second preferred stocks of the Reading Company and the holders of the common stock thereof in relation to the interests of said several classes of stock in the assets and profits of said Company, all of the surplus now existing in the Reading Company and shown on its said statement and all of the surplus that will be created in said Company by the merger of it with the Philadelphia & Reading Railway Company, with the exception of such small part thereof as the holders of said preferred stocks might assert could not be distributed to the common stock because dividends during the years in which it was earned were not fully paid on such pre-

ferred stocks, belongs under the circumstances here obtaining to the holders of the common stock of said Reading Company to the exclusion of the holders of both of said classes of preferred stock.

XIII. That inasmuch as the Reading Company is obliged under the decree of the Court to divest itself of said assets, being the stock and debt of defendant Coal & Iron Company, and under said plan receives therefor considerations which fall short of the value of said assets, it appears to be necessary either (a) to eliminate the surplus of defendant Reading Company as it now exists or to reduce the surplus of the Reading Company as it will exist after the proposed merger with the Philadelphia & Reading Railway Company, or (b) to reduce the capital stock of the Reading Company, provided that the principle of said plan is to be carried out of making an equal distribution to both the preferred and common stocks in connection with the divesting of said assets. That in order to obviate such inequity arising under said plan, your petitioners respectfully suggest the following modification thereof by the addition to article 5 thereof of the following:

"Coincidentally with the issuance and distribution of the certificates of interest in the Coal Company stock, as aforesaid, the Reading Company will reduce its capital stock by the amount of \$. such reduction to apply to all shares of the stock of the Reading Company equally, regardless of classification into preferred and common, and such reduction to be effected by decree of the Court directing it should the Court accept this plan and so decree.

"For the purposes of carrying out such a provision, jurisdiction of the case shall be retained by the Court."

That the amount by which such reduction should be made is the net value of the assets of which the Company is required to divest itself, namely:

The true value of the \$8,000,000 capital stock of the Coal Company and of the \$69,919,770 debt of the Coal Company to the Reading Company, such value to be ascertained in such manner as to this Court shall seem proper and sufficient, less \$25,000,000 bonds and \$10,000,000 cash or current assets to be received from the Coal Company and \$5,600,000 cash to be received from the stockholders.

XIV. That should it appear to this Court that this Court is without power to compel the stockholders of the Reading Company to take proceedings to reduce its capital stock, then your petitioners respectfully suggest as an alternative modification of said plan, to accomplish the requirements of said mandate and still to preserve the equities between the holders of the several classes of stock of the defendant Reading Company in accordance with the contract between them, that in the second paragraph of article 5 of said plan the words:

"Such no par value stock will be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2 for each share of Reading stock"

be deleted and that there be substituted in place thereof the following:

"Such no par value stock will be sold to the holders of the common stock of the Reading Company for an aggregate sum equal to the amount by which the book value of the stock and debt of the Coal Company of which the Reading Company must be divested, after deducting the aforesaid \$10,000,000 in cash or current assets and \$25,000,000 in bonds of

the Coal Company, exceeds the existing surplus of the Reading Company; for illustration:

Value of Coal Company's stock and debt as carried on books of Reading Company, December 31, 1919.	\$77,919,770.
Deduct cash or current assets and bonds to be received from Coal Company	35,000,000.

Net book value of distribution to be made	\$42,919,770.
Surplus of Reading Company (to be brought up to date)	33,201,149.

Amount to be paid by common stockholders to restore capital, or about \$7 per share of Reading common stock (based on surplus shown in December 31, 1919, statement)	\$9,718,621."
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XV. That neither of the aforesaid suggestions will affect the interests of the United States of America, petitioner in this suit, and that if such plan should be modified by either of the methods hereinbefore suggested it will in all respects, so far as such change affects the matter, bring about a situation in full compliance with the requirements of the Supreme Court.

WHEREFORE, your petitioners, having been heretofore permitted by this Court to intervene herein and having filed their petition of intervention, respectfully pray that this amended and supplemental petition suggesting modification of the plan of dissolution may be received and entertained and that said plan of dissolution now before this Court may be modified in any one of the methods

hereinbefore suggested as to this Court shall seem proper and in accordance with equity, and your petitioners will ever pray, etc.

SEWARD PROSSER

MORTIMER N. BUCKNER and

JOHN H. MASON,

As a Committee formed at the request
of Certain Holders of Common Stock
of Defendant Reading Company,

By SEWARD PROSSER

Chairman.

WHITE & CASE,

Counsel for Intervenors,

14 Wall Street,

New York City.

J. DUPRATT WHITE,

Solicitor.

STATE OF NEW YORK, }
 County of New York, } ss.:

SEWARD PROSSER, being duly sworn, says that he is one of the petitioners named in the foregoing petition and is Chairman of the Committee therein named; that he has read the foregoing petition and knows the contents thereof and that the same is true according to his best knowledge, information and belief.

SEWARD PROSSER

Sworn to before me this 14th }
 day of March, 1921. }

ALLEN McCARTY

Notary Public, Queens County,

Certificate filed in New York County,

Term expires March 30, 1922.

Exhibit A.

Certificates of First Preferred, Second Preferred and Common Stock, respectively, of Reading Company. See Exhibit B, Petition of Continental Insurance Company *et al.*, *supra*, pp. 82, 84, 86.

Exhibit B.

READING COMPANY.

Dr.

BALANCE SHEET, DECEMBER 31, 1919.

	AMOUNT.	TOTAL
RAILROAD EQUIPMENT:		
Locomotive Engines and Cars	\$43,890,418 81	
FLOATING EQUIPMENT:		
Sea Tugs, Barges, etc.	4,331,267 31	\$48,221,686
Leased Equipment		20,049,813
Uncompleted Equipment		171,091 2
Real Estate		16,721,411 11
Mortgages and Ground Rents		251,266 6
BONDS:		
Philadelphia and Reading Railway Company's Bonds	\$20,000,000 00	
Bonds of sundry companies (see page 19)	24,683,113 52	44,683,113 52
STOCKS:		
Philadelphia and Reading Railway Company's Stock	\$42,481,700 00	
The Philadelphia and Reading Coal and Iron Company's Stock	8,000,000 00	
Stocks of sundry companies (see page 20)	53,582,303 40	104,064,003 40
THE PHILADELPHIA AND READING COAL AND IRON CO.		69,919,779 40
SUNDRY RAILROADS, ETC. (see page 21)		10,447,112 2
CURRENT ASSETS:		
Cash	\$3,112,957 88	
Notes Receivable	100,000 00	
Central Union Trust Co. of New York, Trustee	6,709 01	
Accrued Income	2,090,050 87	
Current Business	592,019 08	
Philadelphia and Reading Railway Company	110,272 96	
U. S. Railroad Administration, P. & R. Railroad	1,377,536 58	7,302,546 29
UNADJUSTED DEBITS		736 4
		\$127,156,111 6

NOTE.—The foregoing is a reproduction of page 14 of the Twenty-second Annual Report of the Reading Company.

NOTE.—The foregoing is a reproduction of page 15 of the Twenty-second Annual Report of the Reading Company.

Exhibit C.

THE PHILADELPHIA & READING COAL & IRON COMPANY

GENERAL BALANCE SHEET, DECEMBER 31, 1919.

Assets—		Liabilities	
Coal lands.....	\$44,329,554	P. & R. collateral sinking fund loan, 1892-1932.....	\$900,000
Timber lands.....	840,665	Capital stock.....	8,000,000
New York & Eastern depots..	892,834	Reading Company.....	69,919,751
West. Yards & depots.....	2,012,059		
Miners & other houses.....	1,128,901	Total capital accts.....	\$78,819,751
Pottsville shops, real est. & improvements.....	461,105	Current Liabilities:	
Storage yards and washeries..	675,108	Pay rolls & vouchers.....	\$2,400,000
Other real estate.....	423,254	Due for coal purch'd.....	12,000
Improvem'ts & Equip. at collieries.....	14,479,751	Due for royalty on coal mined.....	343,000
Stock & bonds of & loans to Cos. controlled.....	9,919,510	Freight & tolls due foreign roads.....	19,000
		Cos. and individuals.....	514,700
Total capital accts.....	\$75,162,731	Int. due & uncollected.....	0
Stocks, bonds & mtges.....	498,845	Int. & taxes accrued.....	562,000
Investments in U. S. Liberty bonds.....	6,482,546		
Current Assets:		Total current liabs.....	3,866,000
Cash.....	\$2,231,128	Miners' benefic'l fund.....	66,000
Bills receivable.....	7,459	Workmen's compensation fund.....	1,146,000
Coal accounts.....	7,432,053	Contingent fund.....	1,665,000
Rent accounts.....	56,036	U. S. RR Administ'n:	
Cos. & individuals.....	3,230,068	Phil. & Read'g RR.....	5,000
Coal on hand.....	3,436,075	Port Reading RR.....	19,013,000
Supplies & materials.....	3,351,843	Profit and loss.....	
Accrued int. on bonds.....	60,934		
Total current assets.....	\$19,805,596		
Depletion fund.....	1,485,066		
Workmen's fund.....	1,146,304		
Total.....	\$104,581,088	Total.....	\$104,581,088

NOTE—Taken from Poor's Manual of Railroads 1920, page 1134.



Exhibit D

PHILADELPHIA AND READING RAILWAY COMPANY.

Dr.

BALANCE SHEET, DECEMBER 31, 1919.

	AMOUNT.	TOTAL
ASSETS.		
INVESTMENT IN ROAD AND EQUIPMENT.		
Road to June 30, 1907	\$94,724,974 02	
Road since June 30, 1907	24,280,072 70	\$ 19,005,000
Improvements on Leased Railway Property		20,879,751
Miscellaneous Physical Property		1,546,141
INVESTMENTS IN AFFILIATED COMPANIES.		
Stocks	\$185,511 47	
Advances	1,994,895 41	2,180,407
OTHER INVESTMENTS.		
U. S. Liberty Loan Bonds	\$5,907 58	
Miscellaneous	27 43	5,935 01
CURRENT ASSETS.		
Cash	\$673,248 76	
Loans and Bills Receivable	16,789 30	
Miscellaneous Accounts Receivable	12,394,361 82	
Rents Receivable	11,893 78	13,096,392
DEFERRED ASSETS.		
Working Fund Advances	\$1,950 00	
Insurance Premiums Paid in Advance	1,582 37	
Insurance Fund (Cash and Securities)	1,021,536 18	1,023,118
UNADJUSTED DEBITS		
		23,125,440
SECURITIES ISSUED OR ASSUMED—UNPLEDGED		
		2,776,000
		\$173,735,141

NOTE—The foregoing is a reproduction of page 13 of the Twenty-second Annual Report of the Philadelphia and Reading Railway Company.

Exhibit D.

PHILADELPHIA AND READING RAILWAY COMPANY.

BALANCE SHEET, DECEMBER 31, 1919.

Ca.

	AMOUNT.	TOTAL.
LIABILITIES.		
CAPITAL STOCK		\$42,481,700 00
PAID-UP DEBT.		
Prior Mortgage Loan, 1868—1893—1933	\$3,696,000 00	
Improvement Mortgage Loan, 1873—1897—1947	9,328,000 00	
Consolidated Mortgage Loan, 1882—1922—1937, First Series	5,766,717 00	
Consolidated Mortgage Loan, 1893—1933, Second Series	535 00	
Debenture Loan, 1891—1941	8,500,000 00	
Purchase Money Mortgage, 1896	20,000,000 00	
City of Philadelphia Subway Loan, 1914—1922	343,500 00	
Bonds and Mortgages on Real Estate	101,833 61	
Philadelphia and Reading Railway Company Subway Mortgage Loan	2,776,000 00	49,512,585 61
NON-NEGOTIABLE DEBT TO AFFILIATED COMPANIES		381,333 43
CURRENT LIABILITIES.		
Miscellaneous Accounts Payable	\$404,560 53	
Audited Vouchers and Wages Payable	11,877 22	
Interest Matured Unpaid	10,395 00	
Unmatured Interest Accrued	205,146 34	
Unmatured Rents Accrued	357,217 08	
Dividends Accrued and Unpaid	1,650,000 00	2,639,196 19
DEFERRED LIABILITIES		1,373 70
UNADJUSTED CREDITS.		
Tax Liability	\$1,056,469 48	
Insurance Fund	1,009,006 69	
Other Unadjusted Credits	32,662,817 13	34,728,293 30
ADDITIONS TO PROPERTY THROUGH INCOME AND SURPLUS SINCE JUNE 30, 1907		33,383,186 70
Profit and Loss		20,470,338 81
		\$173,738,206 81

NOTE.—The foregoing is a reproduction of page 14 of the Twenty-second Annual Report of the Philadelphia and Reading Railway Company.

Petition of Frances T. Ingraham for Information from the Reading Company as to the Value of Her Interest in the Reading Property.

(Filed March 15, 1921.)

The petition of the above named respectfully represents:

That she resides at 373 Washington Avenue, Brooklyn, New York. That in March, 1921, an order was entered herein granting your petitioner and George S. Ingraham, Robert S. Ingraham, Mabel B. Ingraham and Marcus L. Taft leave to intervene. That such intervenors are holders of 11,050 shares of the common stock of the Reading Company. That your petitioner has been a stockholder of said company for several years. That she has been unable to receive any adequate information as to the segregation of the property of the Reading, as will appear from the annexed affidavits of Floyd W. Mundy, Austin W. Penchoen and George S. Ingraham; that petitioner is informed that said Reading Company proposes to obtain from this Court authority for its plan of segregation of its assets and that your petitioner will be required to elect as to the assets of said company in which she desires to hold an equitable interest; that your petitioner is unable to make such election intelligently until she has been given more definite knowledge of the Reading's assets and that your petitioner in her own behalf and in behalf of the above mentioned intervenors desires an order from this Court which will require the Reading Company to impart to said intervenors such information.

Petitioner therefore respectfully prays for directions of this Court as to how she may obtain such knowledge of the condition of the Reading Company as will permit

petitioner to act intelligently at this critical period in the history of said company.

And she will ever pray.

Dated, Brooklyn, N. Y., March 14, 1921.

FRANCES T. INGRAHAM.

GEORGE S. INGRAHAM,
Attorney for Petitioner,
44 Court Street,
Brooklyn, New York.

STATE OF NEW YORK, }
City of New York, } ss:
County of Kings. }

FRANCES T. INGRAHAM, being duly sworn, deposes and says: that I have read the foregoing petition and am acquainted with the facts stated therein and that such facts are true.

FRANCES T. INGRAHAM.

Sworn to before me this 14th }
day of March, 1921. }

FRED'K BUEHLER,

[SEAL] Notary Public, Queens County N. Y.
Cert. Filed in Kings County.
(County Clerk's Certificate)

STATE OF NEW YORK, }
City of New York, } ss:
County of Kings. }

FLOYD W. MUNDY, being duly sworn says: that he resides at 30 East 60th Street, New York City, N. Y.; that he became engaged in the brokerage business and the study of securities in Chicago in 1899, and that in the year 1901 he came to New York, where he has since resided.

That since 1899 he has continuously devoted a large

part of his time to the study of securities specializing in railroad securities.

That since 1905 he has been a partner in the firm of Jas. H. Oliphant & Co., doing business at 61 Broadway, New York City.

That he has written a number of articles on the subject matter of securities and since 1901 has issued annually, with the exception of two or three years, a book on railroad operations and finances entitled, "The Earning Power of Railroads"; that this book has had a wide circulation and has been more or less recognized as a standard reference book; that deponent has read 90 per cent of all official annual railroad reports issued during the last twenty years.

That he has discussed with men interested in railroad securities on various occasions the Reading Company, and the general opinion seemed to be, and deponent himself shared therein, that the reports of the Reading Company were difficult to analyze and were much more obscure than the average railroad report.

That deponent has never been able to ascertain the value of the Reading Company, although he has been interested therein and has sought for such information; that he is familiar with the leading financial publications of this part of the country, and that among the same are, John Moody and the Wall Street Journal.

That in the Moody weekly letter of May 6, 1920, it is said, after an attempt to estimate the value of the Reading assets:

"Admittedly these estimates are crude. They cannot be otherwise in view of the general lack of evidence as to the actual values of the subsidiary properties. However, they are based upon such income accounts, balance sheets, and market quotations as we have. The indicated value of the equities available in case of dissolution for Reading Company stocks may thus be placed roughly as follows:

Equity in P. & R. Railroad property..	\$106,337,800
In Philadelphia & Reading Coal & Iron property	30,519,300
In Reading Iron Company.....	22,791,500
In Lehigh & Wilkes-Barre Coal Com- pany	16,537,800
In railroad property of the Jersey Central	10,294,000
	<hr/>
	\$186,480,400"

That in the Wall Street Journal of May 5, 1920, it is stated that the estimates for the Reading as now constituted run from \$120 to \$155 per share.

That in the absence of full and complete statements one is unable to determine in full the earning capacity of properties controlled or owned by the parent company.

That in the case of the Reading Company, one confusing item in the Reading reports issued for years past relates to the receipts by the Reading Company of dividends and interest. For example, in the report for 1919, on page 13, under "Receipts" the item appears "Interest and dividends receipts \$11,600,508.48." There is no place in the reports that this item is analyzed.

That the only striking bit of finance which the Reading Company has undertaken in the last 20 years, except for the reduction of maturing bonds, was the issuance of 23 million "Jersey Central Collateral" 4 per cent bonds. These bonds were issued for the purchase at 160 a share of about half of the capital stock of the Central Railroad of New Jersey. The records show that the Central Railroad of New Jersey has never been, since 1902, sold as low as \$160 a share.

That while the Reading Company General Mortgage bonds today are not "legal" investment, they sell from 5 to 8 points higher than other prime legal bonds; and that the preferred stocks today sell in the market for 80 per cent of their face value, while other preferred stocks for years recognized as equal in soundness and

security, sell below 70 per cent of their face value, for example: Norfolk & Western Railway preferred, Union Pacific Railroad preferred, both 4 per cent and non-cumulative stocks.

That this relatively high price for Reading Company preferred stock is doubtless a reflection of the expectation on the part of the holders of these securities, that they will be benefitted by the pending segregation plan.

That in reading the reports of the Reading Company and of the Reading Coal & Iron Company for a period of 20 years, the only statement that is found that presents a real concrete statement of the Reading Company's position in respect to the holding of coal lands, is found in the report of 1901, 8th paragraph, as follows:

"The acquisition of the control of the Jersey Central is not only of enormous advantage because of the additional facilities given to the system, but through this acquisition the Reading System now owned and controlled about 63 per cent of all the unmined anthracite coal in the State of Pennsylvania."

That while the Reading Company is thus considered practically to own and control over 60 per cent of the unmined anthracite coal in Pennsylvania, the Coal Company's profits have for years been small as compared with the profits of other anthracite coal companies, such as the Pennsylvania Coal Company, the Lehigh & Wilkes-Barre Coal Co. (which has recently declared a 150 per cent cash dividend) and the Delaware, Lackawanna & Western Coal Co.

That from the opinion of Justice Clark reported in 253 U. S. 26, it appears that when the Reading Company was reorganized in 1896 a report was made to the New York Stock Exchange that the value of the Reading Coal property was 90 million. That it is proposed that the Reading Coal Company deliver to the Reading Company 25 million dollars worth of bonds and 10 million dollars worth of cash; that the Reading Company is to use 10

million dollars of this as a bonus to the General Mortgage bondholders to release the coal property stock, so that in fact the Reading Company will receive only 25 million dollars for property which was stated to be worth 90 million.

That the balance sheet of the Philadelphia & Reading Coal & Iron Company of December 31, 1918, showed assets of 102 millions of dollars, whereas the entire liabilities, outside of the indebtedness to the Reading Company and the capital stock owned by the Reading Company amount to less than 8 million dollars (see pages 12 and 13 of the 1918 report); that this report would show, therefore, that according to the books of the Coal Company that there was a net value per books of \$94,000,000 belonging to the Reading Company.

Attached hereto as Exhibits "A" and "B" are the forms of certificates respectively of the Reading first and second preferred stocks, which set forth all the rights in the Reading Company of the holders of said stock.

FLOYD W. MUNDY.

Sworn to before me this }
12th day of March, 1921. }

FRED'K BUEHLER,

Notary Public Queens County, N. Y.

Cert. filed in Kings County.

[SEAL]

Exhibit "A".

Certificate of First Preferred Stock printed as part of Exhibit B—Petition of Continental Insurance Company, *et al.*, *supra*, pp. 82, 83.

Exhibit "B".

Certificate of Second Preferred Stock printed as part of Exhibit B to petition of Continental Insurance Co., *et al.*, *supra*, pp. 84, 85.

STATE OF NEW YORK, } ss:
 County of Kings. }

AUSTIN W. PENCHOEN, being duly sworn, says:

That he resides at 379 Ocean Avenue, Brooklyn, New York; that in the month of January, 1897, he was employed as a clerk by the Long Island Loan & Trust Company, then located at 203 Montague Street, Brooklyn, N. Y.; that in 1899 he became the loan clerk for said company and continued in that position until the merger of said company with the Brooklyn Trust Company, in January, 1913, and continued as such until January, 1916, when he was made Assistant Secretary; and that from that date until March, 1920, when he severed his connections with said company, he was in charge of loans and also kept in touch with all financial matters pertaining to all securities held by the Brooklyn Trust Company, both for its own account and also in a fiduciary capacity.

That the Brooklyn Trust Company, by its last public statement, showed assets of over \$49,000,000, of which the loans and discounts amounted to approximately \$14,000,000, and the securities owned by the company were upwards of \$23,000,000; that from 1899 he has been actively interested in securities and that especially during the last seven or eight years he has read many financial publications, viz.: Financial Chronicle, Moody's Analysis, Poor's Manual, The Manual of Statistics, Daily Digest, Brookmire's Service, and many other financial publications relating to securities; that he has acted in advisory capacity to customers; that frequently he would daily have to examine securities of the par value of over \$10,000,000 in connection with his regular business.

That at least as early as the year 1905 he had acquaintances that were particularly interested in Reading securities, and that such acquaintances have continuously therefrom been interested therein; that for said

reason deponent has had a special interest in seeking to acquire information as to the standing of the said Reading Company; that said Reading Company stock was owned to a large extent by those who kept their securities in the Brooklyn Trust Company; that in spite of the Company's issuing annual reports, they are so incomplete and vague that no intelligent opinion could be made of the value of its securities or the earning power of itself or its subsidiary companies.

That the Reading Railway Company's reports do show that it derives a very small percentage of its income from carrying coal produced by the Reading Coal Company; that in 1919 it received only about \$6,000,000 therefrom, while the total income was about \$80,000,000.

That the capital of the Reading Company consists of \$140,000,000, of which \$70,000,000 is common stock, \$28,000,000 first preferred 4% non-cumulative stock, and \$42,000,000 second preferred non-cumulative 4% stock; that the last record of the holdings of the New York Central and the Baltimore & Ohio of the Reading securities that deponent has seen was as of December 31, 1919, and that on that date such holdings were as follows:

	1st Preferred.	2nd Preferred.	Common.
N. Y. Central.....	\$ 6,065,000	\$14,265,000	\$ 9,852,500
Baltimore & Ohio.....	6,065,000	14,265,000	10,002,500
	<hr/>	<hr/>	<hr/>
	12,130,000	28,530,000	19,855,000
			12,130,000
			28,530,000
			<hr/>
		Total,	\$60,515,000

That Reading General Mortgage 4% bonds are not a legal investment in New York State, and yet they sell at a higher market value than high-grade legal bonds, such as Chicago & Northwestern General 4's selling at 74, Atchison General 4's selling at 77, and Northern Pacific prior lien 4's at 75; that the Reading General Lien sell

at 82; that the range of the common and preferred stocks of the Reading for 1920 and 1921 are as follows, to wit:

		Highest.	Lowest.
Reading Common for 1920.....		103	64 $\frac{3}{4}$
do 1921.....		89 $\frac{1}{4}$	67 $\frac{1}{4}$
Reading 1st pfd. in 1920.....		61	32 $\frac{7}{8}$
do 1921.....		55	37 $\frac{1}{4}$
Reading 2nd pfd. in 1920.....		65 $\frac{1}{2}$	33 $\frac{1}{4}$
do 1921.....		57 $\frac{3}{4}$	40

That on March 1st, 1921, the market value of said stocks was as follows, to wit:

Reading common.....	73
Reading 1st pfd.....	45
Reading 2nd pfd.....	46

That since said date and since the reports have appeared in the financial papers of the opposition to the Reading plan, the Reading securities have sold as low as the following, to wit:

Reading common.....	67 $\frac{1}{4}$
Reading 1st pfd.....	37 $\frac{1}{4}$
Reading 2nd pfd.....	40

That since the Reading plan was announced, the sale for the rights for each share of the Reading stock has been as follows:

High	20
Low	13 $\frac{1}{2}$

In paragraph 5 of the Reading plan there is a reference to the proposal to issue assignable certificates of interest in accordance with the Union Pacific-Southern Pacific plan. It should be stated that such certificates carry no interest nor other income to the original holders thereof, but merely are an evidence of title. When assigned, of course, they may become income-paying securities.

That within six months the market value of 11,050

shares of the common stock of the Reading has been in excess of \$1,100,000.

AUSTIN W. PENCHOEN.

Sworn to before me this {
12th day of March, 1921. }

FRED'K BUEHLER,

Notary Public, Queens County, N. Y.

Certificate filed in Kings County.

[SEAL]

STATE OF NEW YORK, {
County of Kings. } ss:

GEORGE S. INGRAHAM, being duly sworn, says: That he resides at 373 Washington Avenue, Brooklyn, New York. As will appear from the petition herein verified the 12th day of March, 1921, and filed in the Clerk's Office herein, and from the affidavits annexed thereto, deponent is attorney for, and has power of attorney from, Frances T. Ingraham, Robert S. Ingraham, Mabel B. Ingraham and Marcus L. Taft; that said Ingrahams and Marcus L. Taft and the deponent are the owners of 11,050 shares of the common stock of the Reading Company.

That all of said Ingrahams have been owners of a large amount of Reading stock for several years, and that Marcus L. Taft has been the owner of Reading stock for several months.

That said beneficiaries are widely scattered and that the petition herein is nominally in the name of Frances T. Ingraham, although in reality it is made for the benefit of each of said parties, as it was not feasible to obtain the signatures thereto of all of such owners; and that said petition was drawn by deponent who has authority to appear herein as attorney for all said beneficiaries;

that deponent during the present month, March, 1921, has examined the papers herein on file in the office of the Clerk of the Court of the Eastern District of Pennsylvania, but can find therein only very vague reference as to the assets of the Reading Company; that although deponent has made diligent efforts to familiarize himself with the value of such assets, he has been unable to do so, and that the reason therefor will appear in part in the accompanying affidavits of Floyd W. Mundy and Austin W. Penchoen.

That the plan of the segregation of the Reading Company was duly received by mail at deponent's office. That, through inadvertence deponent did not read the same till February 28th last and then discovered that he required many papers from these intervenors residing in different States, and in the rush has not had time to arrange the same with the system that he would desire, but that he believes that he can spell out herein all the facts now material. At the hearing herein, March 1, 1921, according to deponent's best recollection, it was stated that the plan was sent to the stockholders under the Court's order.

That the petition of Frances T. Ingraham and others for intervention herein, dated March 12, 1921, and the exhibits thereto attached, are made a part of this application.

GEO. S. INGRAHAM.

Sworn to before me this 12th }
day of March, 1921. }

FRED'K. BUEHLER,

[SEAL] Notary Public, Queens County, N. Y.
Cert. filed in Kings County.

Petition of Adrian Iselin, Robert B. Dodson, Edwin G. Merrill and William A. Law, as a Committee representing certain holders of First and Second Preferred Stock of Reading Company, for Leave to Intervene.

(Filed March 15, 1921.)

**TO THE HONORABLE JUDGES OF THE DISTRICT COURT
OF THE UNITED STATES, FOR THE EASTERN DISTRICT
OF PENNSYLVANIA.**

Your petitioners, Adrian Iselin, Robert B. Dodson, Edwin G. Merrill and William A. Law, as a Committee on behalf of and representing certain holders of First Preferred Stock and Second Preferred Stock of the defendant Reading Company, respectfully file this petition for leave to intervene and allege as follows:

I.

Your petitioners represent the holders of 89,611 shares of First Preferred Stock and 117,786 shares of Second Preferred Stock, having an aggregate par value of \$10,369,850. Holders of First Preferred and Second Preferred Stock of the foregoing amount have executed proxies to your petitioners to appear herein to protect the interests of the holders of the Preferred Stock. The total amount of First Preferred Stock outstanding is \$28,000,000 and of Second Preferred Stock outstanding is \$42,000,000, of which \$40,660,000, par value, First and Second Preferred, as your petitioners are informed, is owned by the Baltimore & Ohio Railroad Company and the New York Central Railroad Company. The persons who have executed proxies to your petitioners are investors and estates who have had no part in framing the so-called plan of reorganization or dissolution of the defendant Reading Company, which plan, pursuant to the

mandate of the Supreme Court of the United States and this honorable Court, was submitted to this Court on or about February 14, 1921.

II.

Your petitioners ask leave to intervene in order to protect the interests of the First and Second Preferred stockholders against the demands of certain common stockholders of defendant Reading Company, who, by the so-called Prosser Committee representing holders of common stock, have filed a petition for leave to intervene and have suggested a modification of the said plan of reorganization or dissolution, which if made or allowed by the Court will seriously impair the rights of the holders of First Preferred and Second Preferred Stock. It is also necessary that your petitioners intervene in order to protect their interests against the demands of holders of any other class of securities of the defendant Reading Company.

III.

Your petitioners aver that the power and authority of this Court extends equally to all classes of security holders of defendant Reading Company, including holders of General Mortgage Bonds, First and Second Preferred and Common stock. This is so because the General Mortgage Bonds and the three classes of stock were each created by and issued under the Plan of Reorganization of 1896, which plan and the corporate organization created pursuant thereto, the Supreme Court has declared unlawful. The decree of this Court entered October 8, 1920, upon the mandate of the Supreme Court directs that the defendants shall submit

“a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh &

Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provisions for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law."

The mandate also directs that

"if defendants shall fail to present a plan within the period stated, or extended, this court will take such further steps as may then seem necessary to dispose of the stock, bonds and property referred to, and to dissolve effectually the unlawful combination so as to recreate out of the elements composing said combination a new situation in harmony with the law."

These four classes of securities—to wit, General Mortgage Bonds, First and Second Preferred and Common Stock, having been created and issued at the same time and under one plan, it follows that so far as the dissolution is concerned they stand alike. If the consent of the General Mortgage Bondholders or of the Trustee under the General Mortgage of 1896 is necessary to the Dissolution plan, then likewise the consent of the First Preferred Stockholders and Second Preferred Stockholders is necessary. We submit that the authority of the Court in enforcing the mandate and recreating a condition in harmony with the law extends equally to all classes of security holders.

IV.

Your petitioners aver to be just and equitable that part of the proposed plan of dissolution which accords the holders of First and Second Preferred Stock the right

to participate with the holders of Common Stock in the purchase of stock of the Coal Company at the rate of \$2.00 for each share of Reading stock.

Under the 1896 plan of reorganization, substantially all the First and Second Preferred Stock and Common Stock, together with many millions of General Mortgage Bonds, were issued and delivered *en bloc* to pay for the properties and assets acquired by the Reading Company. Among the assets so acquired by the Reading Company at that time was a claim of the old Philadelphia and Reading Railroad Company against the Reading Coal and Iron Company for \$68,164,678.99, representing "Advances for Cost of its Property in Excess of its Capital Stock" (Reading Company Balance Sheet, December 1, 1896). As stated above, all the First and Preferred Stock of the Reading Company was issued in part payment, among other things, for said claim of upwards of \$68,000,000, and \$8,000,000 par value of the capital stock of the Philadelphia & Reading Coal & Iron Co., which stock has ever since then been carried as an asset on the balance sheet of the Reading Company worth \$8,000,000. The claim for advances has always been carried on the books of the Reading Company and the Coal Company as an open account. The balance sheet of the Reading Company for December 31, 1919, carries the item at a value of \$69,919,770.06.

The mandate compels the segregation of the Reading Company from the coal properties, the acquisition of which was made possible through the issuance of \$70,000,000 First and Second Preferred Stock in 1896. The mandate further requires that the plan of dissolution establish the "entire independence" of the Coal Company from the Reading Company. Accordingly, in order to obey the mandate, the proposed plan contemplates the elimination from the books of both companies of the said claim for \$69,919,770.06. It is manifest that this would be a distribution of part of the assets to acquire which the preferred stock was issued, and accordingly, the hold-

ers of the preferred stock are entitled to participate in the purchase on an equal basis with the holders of common stock.

V.

Your petitioners aver that the petition for leave to intervene, filed by the so-called Prosser Committee on behalf of certain common stockholders, erroneously states that the effect of the carrying out of said plan is to distribute a surplus of upwards of \$33,000,000 accumulated by the Reading Company from the undivided net profits arising from its business, whereas the facts are as above stated. But your petitioners aver that, even if that were the effect of the plan, the holders of the preferred stock would nevertheless be entitled to share in such a distribution.

The act incorporating the Reading Company (May 24, 1871), in Section 2, declares that said corporation shall enjoy and exercise the same rights, powers, privileges, franchises and immunities as are conferred by the act incorporating the Pennsylvania Company. Section 5 of the latter act (April 7, 1870), provides: "Should the capital stock at any time be increased the stockholders at the time of such increase shall be entitled to a *pro rata* share of such increase upon the payment of the installments thereon duly called for."

The foregoing provision was part of the charter of the Reading Company at the time the preferred stock was issued and no amendment to the charter has ever been made which limits the foregoing rights and privileges of all stockholders, preferred and common alike. It is manifest, therefore, that no distribution of a surplus of the Reading Company by way of a stock dividend could be made without participation therein by the preferred stock. Furthermore, the common stockholders may not seize the surplus to the exclusion of the preferred stockholders by some other method of distribution than a stock dividend.

In the resolutions of the stockholders of the Reading Company, of December 18, 1896, authorizing the First Preferred, Second Preferred and Common Stock, and adopting the forms of certificates thereof, the Reading Company reserves the right, without further consent of the holder, to convert the Second Preferred Stock one-half into First Preferred and one-half into Common Stock. The foregoing provision appears on the face of the Second Preferred Stock Certificate.

No charter amendments of the Reading Company in 1896 were necessary in order to validate the issue of three classes of stock, the issue being authorized by the broad terms of the charter and the existing law.

VI.

Your petitioners aver that the suggested modification of the proposed plan contained in the petition of the common stockholders committee, namely, that the Reading Company reduce its capital stock, such reduction to apply to all shares of the stock of the Reading Company equally, preferred and common alike, is contrary to the terms of the Preferred Stock Certificates which provide that the Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock at par in cash if such redemption shall then be allowed by law.

Your petitioners submit that there is no legal basis for the theory of the common stockholders committee that a surplus not only belongs to the common stock, but is in the nature of a trust fund which is not subject to the exigencies of the business of the company, but must be preserved at all times intact for the common stock and that for the preservation of such surplus the capital stock of the company may be reduced and that such reduction may apply to issues of preferred stock.

But aside from that point, in the present case, the plan for a segregation of the properties adjudged to be

in unlawful combination, contemplates the shifting of certain assets from the Reading Company to the new Coal Company and the distribution of the beneficial interest in the stock of the Coal Company to the stockholders of the Reading Company, preferred and common, *pari passu*.

The debt of the Coal Company to the Reading Company, as above shown, is a part of the capital the latter company acquired by the issue of its stocks and bonds and the adjustment of that debt according to the plan in no respect constitutes a distribution of surplus income or profits as contended by the Common Stockholders' Committee.

The proposed distribution of stock is in conformity with previous decrees of the federal courts under similar circumstances.

The final decree approved by the Court in the *Union Pacific* case, dated June 30, 1913, in Sec. 5, accorded the preferred stockholders of the Union Pacific R. R. Co. as well as the common stockholders the right to subscribe for certificates of interest representing the Southern Pacific Co.'s shares transferred to the Trustee. (Decrees and judgments in Federal Anti-Trust Cases, p. 221.) Said decree provided as follows:

"Section 5. Prior to November 1, 1913, the defendants Union Pacific Railroad Company and Oregon Short Line Railroad Company shall offer to all stockholders of the former, common and preferred (registered as such on a date to be designated in the offer and not more than 40 days from its date) or to their assignees, the right to subscribe for certificates of interest representing the said Southern Pacific Company shares transferred to the Trustee as provided hereunder, substantially in the proportion of their respective holdings, with such allowance in fixing the distribution ratio as the above-named defendants may deem necessary for possible conversions of convertible bonds of the said Union Pacific Railroad Company."

The form of the preferred stock of the Union Pacific R. R. Co. is given in "*Equitable L. A. Society v. U. P. R. R. Co.*, 212 N. Y., 360," p. 365. It provided that "the preferred stock shall be entitled, in preference and priority over the common stock to dividends in each year at such rate not exceeding 4 per cent per annum, payable out of net profits, as shall be declared by the Board of Directors. Such dividends are to be non-cumulative and *the preferred stock is entitled to no other or further share of the profits.*"

Your petitioners aver that in the *Union Pacific* case the preferred stock certificate, after fixing a non-cumulative rate of dividend "not exceeding 4 per cent per annum," provided that "the preferred stock is entitled to no other or further share of the profits." The latter limitation—"no other or further share of the profits"—is not contained in the preferred stock certificates of the Reading Co. On the contrary, under the charter provisions of the Reading Company above set out, the preferred stockholder is entitled to a *pro rata* share of any increase of the capital stock and this provision would apply in case of a distribution of profits by a stock dividend.

Your petitioners aver that under the Pennsylvania decisions the holders of preferred stock are entitled to participate equally with the common in the subscription to the shares of the Coal Company (*Englander v. Osborne*, 261 Penn. St., 366, May 6, 1918).

VII.

Your petitioners aver that the security behind the Preferred Stock of the Reading Co. will be reduced by the plan of dissolution, owing to the fact that the capital stock of Coal Company and its coal properties are to be released from the lien of the general mortgage, and the Coal Company is to be discharged from liability on the

general mortgage bonds. Under the plan it is proposed to pay the bondholders a premium of 10 per cent to secure such release and discharge. The preferred stockholders, whose security is also reduced, are offered no premium for their consent to the plan. The only inducement to them to consent to the plan is the offer of the right to participate equally with the common stock, a junior security, in the purchase of the stock of the coal company.

Your petitioners pray that the plan be approved as submitted and that thereby the litigation which has continued for many years be terminated.

WHEREFORE, your petitioners respectfully pray that an order may be entered in this cause, granting unto your petitioners as a committee as aforesaid leave to file this petition and to intervene herein and become parties in this action, and your petitioners will ever pray, etc.

ADRIAN ISELIN,
ROBERT B. DODSON,
EDWIN G. MERRILL,
WILLIAM A. LAW,

As a Committee Representing
Holders of First Preferred
and Second Preferred Stock
of the Defendant Reading
Company.

March 15, 1921.

By ADRIAN ISELIN.

CADWALADER, WICKERSHAM & TAFT,
40 Wall Street,
New York City.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,
of Counsel.

**Amended Petition of the New York Central Railroad Company for
Leave to Intervene.**

(Filed March 15, 1921.)

Comes now The New York Central Railroad Company and, amending its petition for leave to intervene heretofore filed in the above entitled cause, by this its amended petition respectfully shows:

1. Your petitioner is the owner of the following amounts and classes of the capital stock of the Reading Company:

	Number of shares :	Par value :
First preferred.	121,300	\$6,065,000
Second preferred	285,300	14,265,000
Common	197,050	9,852,500

2. The amount of stock so owned by your petitioner is 21.5589 per cent. of the total capital stock of the Reading Company and, because of its large holding, your petitioner is greatly interested in any plan which the Court may approve for a segregation of the assets of the Reading Company.

3. Because of the fact that your petitioner owns a large amount of each class of stock of the Reading Company, it does not feel that it is in a position to join any of the committees which have been formed to represent the different classes of stock.

Nevertheless your petitioner desires to intervene in this cause for the following reasons: Because committees representing respectively common and preferred stockholders are before the court advancing antagonistic views in support of claims made on behalf of said common and of said preferred stockholders respectively and in derogation of the plan heretofore submitted to the

court by defendants Reading Company, Philadelphia & Reading Railway and the Philadelphia & Reading Coal & Iron Company. Your petitioner desires to support said plan and to present independently the facts, arguments and considerations which it deems appropriate in support thereof.

WHEREFORE your petitioner respectfully prays that it may be permitted to intervene in this cause for the protection of its rights.

And it will ever pray, etc.

THE NEW YORK CENTRAL RAILROAD COMPANY,

by P. E. CROWLEY

Vice-President.

ALEX. S. LYMAN

Solicitor for Petitioner.

3109 Grand Central Terminal,

New York, N. Y.

STATE OF NEW YORK }
County of New York } ss.:

P. E. CROWLEY, being duly sworn, says that he is a Vice-President of The New York Central Railroad Company, the petitioner named in the foregoing petition; that he has read the foregoing petition and knows the contents thereof and that the same is true according to his best knowledge, information and belief.

P. E. CROWLEY

Sworn to before me this }
15th day of March, 1921. }

J. M. WOOLDRIDGE

Notary Public, Westchester County

Certificate Filed in New York & Bronx County.

N. Y. Co. Clerk No. 114 N. Y. Register No. 2110

Bronx Co. Clerk No. 12 Bronx Register No. 2222

My commission expires March 30th, 1922

**Petition of the Baltimore and Ohio Railroad Company for Leave
to Intervene.**

(Filed March 15, 1921.)

The Petition of The Baltimore and Ohio Railroad Company respectfully represents that:

1. The petitioner is the owner of \$6,065,000. at par of the First Preferred Stock, \$14,265,000. at par of the Second Preferred Stock, and \$10,002,500. at par of the Common Stock of The Reading Company.

2. The petitioner is vitally interested in the distribution of the assets of the said Company as directed by the Decree of your Honorable Court in the above cause dated October 8, 1920.

Wherefore your petitioner respectfully prays your Honorable Court to permit it to intervene for the protection of its rights.

And it will ever pray, etc.

THE BALTIMORE AND OHIO RAILROAD COMPANY,
By DANIEL WILLARD,
President.

H. B. GILL
HUGH L. BOND, Jr.
Solicitor for Petitioner.

STATE OF MARYLAND }
City of Baltimore } ss.

DANIEL WILLARD being sworn according to law, deposes and says that he is the President of The Baltimore

and Ohio Railroad Company, the above Petitioner, and that the facts set forth in the above Petition are true.

DANIEL WILLARD

President.

Sworn to and subscribed to before me this 11th day of March, 1921.

GEORGE W. HANLEENBECK

Notary Public

My commission expires May 1, 1922.

[SEAL]

Petition of William B. Kurtz and Madge Fulton Kurtz for Leave to Intervene.

(Filed March 15, 1921.)

The petition of William B. Kurtz and Madge Fulton Kurtz respectfully represents:

1. Petitioner William B. Kurtz is the owner of four thousand one hundred (4,100) shares of the Second Preferred Stock of the Reading Company; petitioner Madge Fulton Kurtz is the owner of one thousand (1,000) shares of the Second Preferred Stock of the Reading Company.

2. Petitioners are vitally interested in the distribution of the assets of the Reading Company as directed by the decree of the Court entered in this case on October 8, 1920.

Petitioners, therefore, respectfully pray this Honorable Court to permit them to intervene for the protection of their rights.

And they will ever pray, &c.

WILLIAM B. KURTZ

MADGE FULTON KURTZ

Petitioners.

T. R. WHITE

Attorney for Petitioners.

STATE OF PENNSYLVANIA }
 County of Philadelphia } ss:

WILLIAM B. KURTZ, being duly sworn according to law, deposes and says that he is one of the petitioners named in the foregoing petition, and that the facts set forth therein are true.

WILLIAM B. KURTZ

Sworn to and subscribed be-
 fore me this 5th day of }
 January, A. D. 1921. }

ANNA M. LEVY

[SEAL]

Notary Public

Petition of the Penn Mutual Life Insurance Company for Leave to Intervene.

(Filed March 15, 1921.)

The Petition of the Penn Mutual Life Insurance Company respectfully represents that:

1. The petitioner is the owner of \$1,000,000. at par of General Mortgage 4% Bonds of the Reading Company and the Philadelphia & Reading Coal & Iron Company, dated January 5, 1897 and due January 1, 1997.

2. The petitioner is vitally interested in the distribution of the assets of the said Companies as directed by the Decree of your Honorable Court in the above cause dated October 8, 1920.

Wherefore your petitioner respectfully prays your Honorable Court to permit it to intervene for the protection of its rights.

And it will ever pray, etc.

THE PENN MUTUAL LIFE INSURANCE COMPANY,
 By GEO. K. JOHNSON Prest

G. W. PEPPER
 Solicitor for Petitioner.

COMMONWEALTH OF PENNSYLVANIA } ss.
 County of Philadelphia }

GEO. K. JOHNSON, being sworn according to law, deposes and says that he is the President of the Penn Mutual Life Insurance Company, the above petitioner, and that the facts set forth in the above Petition are true.

GEO. K. JOHNSON

Sworn to and subscribed before me this eighth day of March, 1921.

FRANK J. REEVES

[SEAL]

Notary Public

Petition of the Girard Avenue Title and Trust Company to Intervene.

(Filed March 15, 1921.)

TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
 OF THE UNITED STATES FOR THE EASTERN DISTRICT OF
 PENNSYLVANIA:—

The petition of The Girard Avenue Title and Trust Company respectfully represents:

1. That your petitioner is the owner of nine hundred of the common shares of the Reading Company and of bonds known as the 4% general mortgage bonds of the Reading Company to the amount of \$15000. par value.

2. Your petitioner avers that it is vitally interested in the distribution of the surplus owned by said Reading Company, and is otherwise interested vitally in the distribution and plan proposed in the carrying out of the decree entered in this case.

Your petitioner therefore prays that it be permitted to intervene in this cause of action for the protection of its rights in the premises.

Your petitioner will ever pray

GIRARD AVENUE TITLE & TRUST CO.

By WILLIAM H. GARGES

Secretary.

STATE OF PENNSYLVANIA }
 Eastern District of Pennsylvania } ss.

WILLIAM H. GARGES, having been duly sworn according to law, deposes and says that he is the Secretary and Treasurer of the said The Girard Avenue Title and Trust Company, the above named Petitioner, and that the facts set forth in the foregoing petition are true of his own knowledge.

WILLIAM H. GARGES

Sworn to and subscribed }
 before me this 14th day }
 of March, 1921. }

ANNA M. MELLON

[SEAL]

Notary Public —

I hereby certify that I am not a Director or officer of the above Trust Company.

ANNA M. MELLON

Petition of the Pennsylvania Company for Insurances on Lives and Granting Annuities, et al, for Leave to Intervene.

(Filed March 15, 1921.)

The Petition of The Pennsylvania Company for Insurance on Lives and Granting Annuities, individually and in its capacity as Trustee, Administrator, Executor or Guardian, as the case may be, for an aggregate of 155 estates, person or corporations (List contained in original), respectfully represents:

1. That the petitioner individually and in its various capacities above set forth, is the owner of \$2,041,000. par value of general mortgage 4% bonds of the Reading Company and the Philadelphia and Reading Coal and Iron Company, secured under Indenture of Trust dated January 5, 1897, said bonds being due January 1st, 1997.

2. The petitioner is vitally interested in the distribution of the assets of the said Companies as directed by the decree of your Honorable Court in the above case dated October 8, 1920.

Wherefore your petitioner individually and in its various capacities as above set forth respectfully prays your Honorable Court to permit it to intervene for the protection of its rights.

And it will ever pray, etc.

THE PENNSYLVANIA COMPANY FOR INSURANCES
ON LIVES AND GRANTING ANNUITIES, individ-
ually and in its various capacities as above
set forth.

By C. S. W. PACKARD
President.

STATE OF PENNSYLVANIA }
County of Philadelphia } ss

C. S. W. PACKARD, being duly sworn according to law deposes and says that he is the President of The Pennsylvania Company for Insurances on Lives and Granting Annuities, the foregoing petitioner, and that the facts set forth in the foregoing petition are true.

C. S. W. PACKARD

SWORN to and SUBSCRIBED }
before me this 12th day }
of March, A. D., 1921. }

HARRY BOWER

[SEAL] Notary Public.

My commission expires Jan. 28, 1925

I am not a Stockholder, Director or Officer of within mentioned Corporation.

Petition and Answer of Joseph E. Widener.

(Filed March 15, 1921.)

TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
OF THE UNITED STATES WITHIN AND FOR THE EASTERN
DISTRICT OF PENNSYLVANIA :

Now comes Joseph E. Widener and craves leave to intervene and to present a separate answer to certain of the intervening petitions and cross-petitions filed herein, and so petitioning and answering respectfully represents:

1. That he is a member of the Board of Directors of the Reading Company and has been such since the final decision and mandate of the Supreme Court in this proceeding.

2. That he is one of the trustees of the Estate of P. A. B. Widener, his father, which estate is the owner of 100,000 shares of the common stock of the Reading Company, or a one-fourteenth part thereof; that in addition to his holding as trustee he is a beneficiary of said estate to the extent of 50 per cent., and is also the owner and representative of an additional substantial amount of the common stock of the Reading Company; that he has no interest directly or indirectly in either issue of preferred stock.

3. That since the entry of the final decree in this proceeding he and his co-directors have earnestly endeavored to formulate a plan for carrying out the mandate of the Court, which plan would command the approval of the Department of Justice and of this Honorable Court, preserve as far as possible the equities of the owners of the different classes of stock and bonds of the Company and be capable of execution in the present disturbed condition of world finances with the least possible loss to any of the interests involved. That the plan heretofore presented to this Honorable Court by the Board of Directors

of the Reading Company has been formulated and submitted after careful and extended consideration as the best method available to meet these ends. That your petitioner as a member of the said Board has approved, and still approves, this plan as submitted.

4. Your petitioner further desires to record his approval of the plan as a common stockholder of the company. He desires however to register a disclaimer and protest with respect to the attempt of certain intervening interests to obtain in this proceeding a construction of the basic contracts between the different classes of stockholders of the Reading Company. Your petitioner respectfully represents that the action contemplated under the present plan for compliance with the mandate of the Supreme Court is in no sense a distribution of current income or surplus profits of the Company, nor of the corporate assets upon abandonment of the joint enterprise undertaken by the stockholders. The present plan merely effectuates, by sale, a return to those who contributed it, of certain corporate property which the Supreme Court has determined that the Reading Company had no legal right to acquire and has no legal right to hold. Such a segregation of property in compliance with the mandate of the Court does not involve any construction of the basic contracts between the different classes of stockholders and the company; it is not a distribution of profit, surplus or corporate property in the customary management of the corporate business.

5. Your petitioner believes that great injustice will result if, in connection with this judicial segregation of property, the decree of your Honorable Court shall in any way place a construction upon the contracts between the several classes of stockholders and the company, defining their rights in customary corporate distributions, or shall identify or designate this special segregation in terms of customary corporate distributions.

6. Your petitioner had originally given to the intervenors known as the "Prosser Committee" and representing the holders of common stock, his power of attorney. He has felt constrained to withdraw that power and to present this separate answer for the reasons stated herein.

Wherefore your petitioner prays that this Honorable Court in its decree in this proceeding will refrain from any judicial construction of the contracts between the different classes of stockholders and the company, which questions of construction, although interjected by the protests of certain interests, are not as your petitioner verily believes in any way raised or involved in this proceeding.

And your petitioner will ever pray.

JOSEPH E. WIDENER.

.....
ELLIS AMES BALLARD,
Solicitor for Petitioner.

BALLARD, SPAHR, ANDREWS & MADEIRA,
Of Counsel.

April 6th, 1921.

Answer of Central Union Trust Company of New York.

(Filed April 12, 1921.)

The defendant, CENTRAL UNION TRUST COMPANY OF NEW YORK (formerly Central Trust Company of New York), as Trustee under the General Mortgage made by the Reading Company and the Philadelphia & Reading Coal & Iron Company, dated January 5, 1897, being made a party hereto, by supplemental bill filed herein under

authority and order of the court, for answer to the bill of complaint and supplemental bill, says :

I. It is stranger to all and singular the matters and things in said bill of complaint contained, and therefore leaves the plaintiff to make such proof thereof as it shall be able to produce.

II. It admits the allegations contained in the supplemental bill of complaint in the paragraphs numbered respectively 1, 2, 3 and 4. As to the allegations contained in the paragraph of the supplemental bill of complaint numbered 5, it begs leave to refer to the Plan therein referred to, and now filed with this court, for the terms and conditions thereof.

**FURTHER ANSWERING THE BILL OF COMPLAINT AND THE
SUPPLEMENTAL BILL OF COMPLAINT.**

III. It asserts and alleges that it has no interest in the stock of the Reading Company, and only such interest in the stock of the Philadelphia & Reading Coal & Iron Company as it has as Trustee under said General Mortgage, and it begs leave to submit to the court the said General Mortgage, or a copy thereof, for the purpose of placing before the court all the terms and conditions thereof, and its rights, duties and obligations as Trustee thereunder.

IV. It asserts and alleges that all of the bonds, the issuance of which is provided for by the said General Mortgage, were not authenticated and delivered at the time of the execution of said General Mortgage, but that bonds thereunder have since such time, pursuant to the terms of and for the purposes prescribed in said mortgage, been authenticated, issued and delivered from time to time up to the year 1920.

V. It further alleges that it is informed and verily believes that the bonds secured by said General Mortgage are numerous and widely scattered, and few of the owners thereof, if any, are in any way identified with the management of the properties of the Reading Company or the Philadelphia & Reading Coal & Iron Company, or either of them, or any of their subsidiaries, and that such management is entirely independent thereof, and that such bondholders have not, nor did they ever have any part in the alleged illegal conspiracy set forth in the bill of complaint herein.

VI. It further alleges that it is informed and verily believes that it is not necessary that the said mortgage or the lien thereof should in any wise be disturbed in order to fully carry out and comply with the mandate of the Supreme Court of the United States in this action, and that in this action, the court is without power to disturb the same.

WHEREFORE, this defendant, having fully answered, prays for relief that no decree shall be entered herein that will in any wise disturb the said mortgage or the lien thereof on any security thereunder, or the security of the holders of bonds secured by said mortgage as in said mortgage provided, and that any decree entered shall recognize the unimpaired validity of said mortgage and the lien and pledge thereby created.

JOHN M. PERRY,
Solicitor for Defendant, CENTRAL
UNION TRUST COMPANY OF NEW
YORK, Trustee.

LARKIN, RATHBONE & PERRY,
Counsel,
80 Broadway,
New York City.

STATE OF NEW YORK, }
County of New York, } ss.:

FREDERIC J. FULLER, being duly sworn, deposes and says that he is an officer, to wit, a Vice President of Central Union Trust Company of New York, the corporation above named; that he had read the foregoing answer and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and as to those matters he believes it to be true.

The reason this verification is made by deponent instead of by Central Union Trust Company of New York is that Central Union Trust Company of New York is a corporation, and deponent is an officer of said corporation.

FREDERIC J. FULLER

Sworn to before me this 7th }
day of March, 1921. }

R. C. ROETGER

[SEAL] Notary Public, Westchester County
Certificate Filed in New York County No. 252
New York County Register's No. 2208
Term Expires March 30th, 1922

Answer to Intervening Petitions, and Cross-Petition of Defendant
Reading Company.

(Filed April 5, 1921.)

TO THE HONORABLE THE JUDGES OF THE DISTRICT COURT
OF THE UNITED STATES, FOR THE EASTERN DISTRICT OF
PENNSYLVANIA.

Now comes the defendant Reading Company, answering the intervening petitions filed herein by (1) Seward Prosser, Mortimer N. Buckner and John H. Mason, as a

Committee (hereinafter called the Prosser Committee), (2) Continental Insurance Company and Fidelity-Phoenix Insurance Company of New York, and (3) Frances T. Ingraham, and respectfully represents unto this Honorable Court as follows:

I.

The Reading Company and its board of directors do not offer any objection to intervention in this cause by stockholders of the Reading Company, on the terms hereinafter suggested, though they hesitate to join in the request of the petitioners that they be permitted to intervene, lest such action be misconstrued as calculated to delay the execution of the mandate of this Honorable Court. If, however, the Court should determine to grant permission to the petitioners to intervene, the Reading Company and its board of directors would welcome such action as tending to relieve them of the sole responsibility in a matter which is evidently controversial.

The Reading Company and its board desire that the views of the intervening common stockholders of the Reading Company be considered on their merits and they approach the discussion of them in no contentious spirit. They cannot, however, accept the view that the assertion of conflicting claims on behalf of some of the holders of its common stock relieves the duly elected directors of the Reading Company of the responsibility imposed upon them by law.

No part of the plan submitted to this Honorable Court on February 14, 1921, was adopted without careful consideration. The board of directors of the Reading Company approached the problem from the point of view, first, of obeying the mandate of this Court; second, of avoiding as far as possible the disturbance of existing securities; third, doing justice between existing classes of security holders. The members of the board of direc-

tors of the Reading Company are, and for years have been, for the most part, personally or in a representative capacity, holders of large amounts of stock, preferred or common or both, of the Reading Company. They are advised and believe that this fact, so far from disqualifying them from exercising their judgment, and reaching a determination upon the problems presented by the decree of this Honorable Court, is, in itself, an important qualification. Subject to the overshadowing necessity of responding frankly, promptly and fully to the mandate of this Honorable Court, it has been the primary concern and the guiding principle of the board of directors of the Reading Company, during months of anxious consideration, to devise a plan which should not merely destroy but conserve, not obstruct the Government but re-construct the properties.

The Reading Company and its board of directors have presented such a plan, which, if they are correctly advised, has met the approval of the Government of the United States in every important respect except one. That plan is now before this Honorable Court for consideration. The Reading Company and its board have assumed that that plan and, indeed, any plan which should undertake not merely to tear down but also to re-construct, must be to some extent dependent upon corporate action on the part of the Reading Company by its board of directors and its stockholders. Though in an important sense compulsory because taken under pressure of necessity created by the decree of this Honorable Court, the plan must be regarded as in some sense also voluntary since it requires corporate action not directly involved in the issues in this cause. Accordingly the Reading Company and its board have assumed that if this Honorable Court should approve the plan it would be necessary to call meetings of stockholders of the Reading Company and submit to such stockholders for their consideration proposals for the taking of the

appropriate corporate action to consummate the plan. The Reading Company and its board have not as yet communicated with the stockholders as a body further than to mail to them the plan itself and the brief statement of it hereto annexed marked Exhibit A.

The Reading Company is advised and believes that if this Court should sustain the objections of the intervening common stockholders its decision would be fatal to the present plan, and that the counter-proposals advanced on behalf of those common stockholders are unprecedented and impracticable and, far from putting an end to controversy, would inflame it. The Reading Company and its board of directors believe it to be their duty to oppose the views and proposals presented on behalf of the intervening common stockholders because if their objection were sustained the consequence must be to drive this Court to still more drastic measures than are contemplated by the plan. The consequent great loss and expense must reduce or exhaust the accumulated surplus, and whatever assets remained would, as the Reading Company is informed and believes, in the event of a decree enforcing a more drastic dissolution of the Reading Company, unquestionably be the property of the stockholders, preferred and common, share and share alike, without discrimination or preference. Holding these views as to the interests of the stockholders, and being primarily concerned to conserve their property, the board of directors of the Reading Company, after very careful consideration of the views presented on behalf of the intervening common stockholders, though interposing no objection to the granting of the petitions to intervene and, indeed, welcoming such intervention if approved by the Court, is constrained to oppose the further relief asked on behalf of the intervening common stockholders.

II.

The Reading Company is a corporation specially chartered under the laws of Pennsylvania prior to the adoption of the Constitution of 1874, with particularly broad powers. It was originally known as Excelsior Enterprise Company. A copy of its charter and of the charter of the Pennsylvania Company therein referred to is hereto attached marked Exhibit B. The Reading Company is not a common carrier and is not subject to regulation by Federal or State authorities having jurisdiction over railroads. The Reading Company has outstanding capital stock as follows:

4% non-cumulative First Preferred Stock	\$28,000,000.00
4% non-cumulative Second Preferred Stock	42,000,000.00
Common Stock	70,000,000.00
<hr/>	
Total Capital Stock.....	\$140,000,000.00

Copies of the stock certificates are hereto attached marked Exhibits C, D and E.

The Reading Company now owns all the stock (par value \$42,481,700) of the Philadelphia and Reading Railway Company (hereinafter called the Railway Company), and all the stock (par value \$8,000,000) of The Philadelphia and Reading Coal and Iron Company (hereinafter called the Coal Company).

The Reading Company and the Coal Company are joint obligors under a General Mortgage to Central Trust Company of New York, Trustee, dated January 5, 1897 (hereinafter called the General Mortgage). The General Mortgage Bonds mature January 5, 1997, bear interest at 4%, and are the joint obligations of the two companies. Bonds to the amount of \$96,524,000 (including \$2,831,000 in the Treasury) were outstanding December 31, 1919, and on December 31, 1920, there were outstanding \$95,980,000

of which \$2,711,000 were in the Treasury of the Company. The properties mortgaged and pledged under the General Mortgage include the properties of the Coal Company, the railroad equipment and certain real estate owned by the Reading Company, all the stock of the Coal Company and of the Railway Company, and certain bonds of the Railway Company.

The Reading Company now owns stock of the Central Railroad of New Jersey (hereinafter called the Jersey Central) to the par amount of \$14,504,000, which constitutes more than a majority of its stock. All the stock of the Jersey Central (except 40 shares) owned by the Reading Company is pledged under the Jersey Central Collateral Trust Mortgage of Reading Company to the Pennsylvania Company for Insurances on Lives and Granting Annuities, Trustee, dated April 1, 1901. The bonds issued under this mortgage bear interest at 4%, mature April 1, 1951, and are redeemable before maturity at 105 per cent. of the par value thereof and accrued interest. Bonds to the amount of \$23,000,000 are issued and outstanding.

Prior to 1896 the Reading Company was an inactive corporation, with an authorized capital stock of \$100,000. Its charter had been kept alive and was in the possession of The Philadelphia and Reading Railroad Company (hereinafter called the Railroad Company). In 1896 a reorganization of the properties of the Railroad Company and the Coal Company became necessary by reason of the foreclosure of the General Mortgage of said companies.

The reorganization plan dated December 14, 1895, was formulated by a Committee composed of the following gentlemen: Frederic P. Olcott, Adrian Iselin, Jr., J. Kennedy Tod, Henry Budge, Thomas Denny, George H. Earle, Jr., Sidney F. Tyler, Samuel R. Shipley and Richard Y. Cook. Its Counsel were F. W. Whitridge, John G. Johnson and George L. Rives. The Depositaries under the plan were J. P. Morgan & Co., New York, Drexel & Co.,

Philadelphia, and J. P. Morgan & Co., London. Their Counsel was Francis Lynde Stetson. In the Agreement dated December 14, 1895, to which the plan was prefixed, J. P. Morgan & Co. were designated Managers. The reorganization plan provided for the issue of general mortgage bonds, preferred stock and common stock, as follows:

"1. General Mortgage 100-year 4% Gold Bonds.

* * * * *

2. Non-cumulative 4% First Preferred Stock for \$28,000,000, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock. The First Preferred Stock will entitle the holders to non-cumulative dividends up to 4 per cent. per annum, payable out of net earnings before any dividends shall be paid on the Second Preferred or the Common Stock.

3. Non-cumulative, 4% Second Preferred Stock for \$42,000,000, which will entitle the holders to non-cumulative dividends up to 4 per cent. per annum, payable out of net earnings before any dividends shall be paid on the Common Stock.

4. Common Stock for \$70,000,000, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock.

* * * * *

Provision will be made that at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the First Preferred Stock, the New Company may convert the Second Preferred Stock at par, one-half into First Preferred Stock and one-half into Common Stock."

The properties formerly of the Railroad Company and the Coal Company were sold under foreclosure and bought in by Charles H. Coster and Francis Lynde Stetson, who acted by arrangement with the Managers. The securities

issued by the Reading Company in connection with the reorganization plan (all the preferred stocks and common stock now outstanding and \$50,369,000 principal amount of General Mortgage Bonds) were issued against the acquisition of the properties of the Railroad Company and the Coal Company sold under the foreclosure decree and were exchanged for outstanding securities of the Railroad Company or sold to provide the cash necessary for organization purposes.

The General Mortgage dated January 5, 1897, under which the General Mortgage Bonds so provided for in the plan were issued, provides as follows:

"Sec. 2. Of the bonds authorized to be issued under and secured by this indenture, bonds to the amount of fifty million three hundred and sixty-nine thousand dollars (\$50,369,000), immediately upon the execution or delivery hereof, or as soon as may be thereafter, shall by the Trustee be certified and delivered to the firm of J. P. Morgan & Co., or their survivors or successors, as Reorganization Managers, without accountability by said firm, or such survivors or successors, for the disposition or use thereof."

On the balance sheet of the Railroad Company for November 30, 1896, the item "Investment in P. & R. Coal & Iron Co. \$70,358,996.01," was carried as an asset. The purchasers conveyed the railroad to the newly organized Railway Company, the railroad equipment and various securities to Reading Company, and the coal properties to the Coal Company. The "Deed, Charles H. Coster and Francis Lynde Stetson to The Philadelphia and Reading Coal and Iron Company, dated November 18, 1896", contained the following recital:

"AND WHEREAS, The parties of the first part did also purchase, and now own and possess certain claims or demands for an aggregate principal sum exceeding \$69,000,000 formerly of The Philadelphia

and Reading Railroad Company against the party of the second part, as follows, to-wit:

- (1) A mortgage bond of the party of the second part, dated July 1, 1874, for the sum of \$30,000,000.00
- (2) A mortgage bond of the party of the second part, dated December 28, 1876, for the sum of 10,000,000.00
(Subject to all prior charges and claims against said two mortgage bonds.)
- (3) Loan account, representing cash advances 24,879,336.16
- (4) Current business account, approximating 4,300,000.00

AND WHEREAS, It is the desire and intention of the parties hereby to vest in and to transfer to the party of the second part the titles to the several properties hereinafter described, free and discharged from the four claims before mentioned, which four claims (subject to a prior pledge of said two mortgage bonds) are hereby transferred to the party of the second part;”

These claims composed the item “Investment in P. & R. Coal & Iron Co.” mentioned above. Although these claims were extinguished, these items were carried on the balance sheets of the Reading Company and the Coal Company as of December 1, 1896, and have been so carried ever since, the exact amount varying as certain advances were made by the Reading Company or repayments by the Coal Company. The amount now carried is approximately \$70,000,000.

As long as the Reading Company held all the stock of the Coal Company, this was only a matter of bookkeeping and made no real difference in the financial status of the two companies. The cancellation provided for by the proposed plan is therefore only a rectification of the bookkeeping.

The view taken by the Reading Company of this matter is not uncontroverted. But it is not material for the purposes of the discussion with the intervening common stockholders whether the item is a genuine debt or not, for the Reading Company does not question the fact that the book value to the Reading Company of its investment in the Coal Company on December 31, 1920, was \$77,357,017.99. The principles here involved will not, therefore, be affected by any discussion of the genuineness of this item. To this extent the Reading Company finds itself in accord with the views expressed in the first brief submitted on behalf of the Prosser Committee.

III.

The coal stock is to be *sold*. There is to be no dividend or distribution of the coal stock. The situation is not such as to justify declaring a dividend in respect of the coal stock. No extraordinary dividend has been or will be declared by the Reading Company. The common stockholders cannot force a dividend nor can the sale be treated as if a dividend had been declared. The loss in book value from the sale could, if it were necessary, be charged against the Reading Company's profit and loss surplus without creating any valid claim for preferential treatment of common stock. The sale is compulsory and will result in a loss, not a profit.

The book value of the coal property on the books of the Reading Company, taking the par amount of the stock plus the nominal amount of the above-mentioned claim, as of December 31, 1920, was \$77,357,017.99. As of December 1, 1896, it was \$76,154,678.99.

The aggregate consideration to be received by the Reading Company against the coal property in bonds and cash (out of which must be provided a sum not exceeding \$9,400,000 for payment to the General Mortgage bond-

holders who accept the offer contemplated by the plan) is as follows:

Cash and cash assets from Coal Company	\$10,000,000.00
4% Mortgage Bonds of Coal Company at par.....	25,000,000.00
Cash from stockholders.....	5,600,000.00
Total	\$40,600,000.00

This consideration is less than it is hoped will prove to be the intrinsic value of the coal property. It is, however, a substantial, not a nominal, consideration and is in the judgment of the board of directors of the Reading Company adequate for the requirements of the Reading Company. In view of the fact that a good part of the anthracite coal fields in the country are actually or potentially on the market, that the General Mortgage is, for the time being at least, an incumbrance upon the property, that the earning power of the coal property under independent management remains to be demonstrated, and that stockholders of the Reading Company cannot become owners of the coal stock itself, though they may purchase certificates of interest provided for in the plan, it is believed that the coal stock cannot be sold under pressure of the decree in this cause for a sum as great as its book value.

It is evidently impracticable to ascertain the market value of the coal stock under these conditions without offering it for sale. An appraisal would be of no use whatever under the circumstances. The Reading Company is under the necessity of making an actual disposition of the stock and no theoretical valuation of appraisers or experts could be of the least service unless they were willing and able to back the appraisal with a bid.

The coal stock is being sold for less than its book value and it is not asserted on behalf of the intervening common

stockholders that it can be sold for as much as its book value. The sale results in a loss on the books of the Reading Company, yet the intervening common stockholders ask that it be treated as a distribution of profits and that the preferred stockholders be excluded from participation in the purchase on that theory. It is, however, entirely clear that, though the intervening common stockholders may object to the Reading Company's taking the loss, if they are prepared to make or suggest a better offer, they cannot have it treated as a profit entitling them to exclusive participation, as in the case of dividends from current profits in excess of 4%.

If the stockholders believe that the Reading Company should realize a larger value for the property, and indicate to the Board their desire to pay a larger price for it, such an offer would receive the careful consideration of the Board. If, however, upon consideration the stockholders are satisfied with the price fixed by the Board, neither class can complain on the ground that the other has not been excluded from participation in the purchase. If the intervening holders of common stock object to having certificates of interest in the coal property sold to the preferred and common stockholders ratably, the remedy of the common stockholders is to offer a higher price, with the right to the preferred stockholders to bid against them; or to ask the court to require that the certificates of interest be sold at public sale to the highest bidder, with the right to the stockholders, preferred and common, singly or in groups, and to the general public, to bid.

IV.

The thing to be sold, the stock of the Coal Company, is a capital asset, and not in any sense earnings or profits of the Reading Company. The book value to the Reading Company of its investment in the coal property is not materially greater than it was twenty-five years ago on

the reorganization of the Reading Company. It is not alleged that its present market value under the circumstances above indicated is more than its book value. It is idle to argue that the Coal Company has undistributed earnings and that these are the property of the owners of the common stock of the Reading Company, since the aggregate market value of the coal property, including undistributed earnings if any, is not alleged to be more than the book value to the Reading Company.

Copies of the balance sheet of the Coal Company as of December 31, 1920, and of its income accounts from December 31, 1915, to December 31, 1920, are hereto annexed marked Exhibit F.

V.

Even if the sale of the coal stock reduced or wiped out the surplus of the Reading Company, that fact would not in any manner alter the rights of the stockholders in respect of such sale or make such sale a distribution of the surplus of the Reading Company. It is the nature of the asset disposed of, and the method of its disposition, not the effect of such disposition on the books of the corporation, which fixes the rights of stockholders in respect of such disposition. The earnings of any corporation are part of its general assets, are at the hazard of the business, and can be used for any number of corporate purposes of which the payment of dividends is only one. Common stockholders have no right in earnings until that right has been created by the declaration of a dividend and they have no right to require a dividend to be declared in the absence of bad faith on the part of the Board of Directors.

VI.

The capital of the Reading Company will remain unimpaired. Upon the consummation of the plan the assets of the Reading Company will exceed the aggregate

of its capital stock and liabilities by an amount in excess of the present surplus of \$33,000,000, as more fully appears under VII. There can be no reduction of capital stock, preferred or common, except with the consent of stockholders required by the statute, or as provided in the contract, when the capital is unimpaired and is required for use in the business. The only way to reduce the preferred stock without its consent is to redeem it in accordance with the terms of the contract in the stock certificates. Funds are not available for that purpose.

If it had appeared that the market value of the coal stock under the existing circumstances was as great as many believe its intrinsic value to be, much could have been said in favor of a proposal to convert the second preferred stock one-half into first preferred and one-half into common, redeem at par the first preferred stock, which would then amount to \$49,000,000, and sell the coal stock to the holders of the common stock, which would then amount to \$91,000,000, for a sum sufficient to provide for such redemption in addition to the other cash requirements of the plan. Such a plan would have been contingent upon selling the coal stock, or certificates of interest in it, under an arrangement by which the proceeds of sale would not be deposited under the General Mortgage but would be applied to the redemption of the preferred stock, a junior security. Under the actual conditions now existing it did not appear to the Board of Directors that such a plan was fair, wise or feasible.

The participation of the preferred stock in current dividends is limited to a rate per cent. of capital. The reduction of the preferred stock would therefore reduce the dividends payable to the holders of preferred stock. The dividends on the common stock, on the other hand, are not limited to a rate per cent. of capital. The reduction of the common stock would not therefore reduce the amount payable in dividends to the common stock, but in fact might result in making possible somewhat higher divi-

dends on common stock in consequence of the reduction of dividends on preferred stock as above explained.

The proposal to reduce the capital stock does not, however, for practical reasons commend itself to the Reading Company. It will not, it is believed, commend itself to the common stockholders themselves. Even if it be assumed that the market value of the coal stock is more than the selling price under the plan, it is the difference between the selling price and the market value, not the difference between the selling price and the book value, as seems to be assumed by the intervening petitioners, which is the real subject of contention. If it be assumed, merely for illustration, that the certificates of interest in the coal stock provided for in the plan could be sold for cash in an amount greater by as much as \$7,000,000 than the price fixed by the plan, then under the intervenors' proposal the capital stock, preferred and common, should be reduced by \$7,000,000, or 5%. The aggregate par value of every stockholder's holdings would be scaled down 5%. The aggregate capital stock of the company would be reduced from \$140,000,000 to \$133,000,000. Every holder of a hundred share lot, or \$5,000 par value of the stock, preferred or common, would receive certificates for an "odd lot" of shares, namely, 95 shares of the par value of \$4,750. In order to avoid the issue of fractional shares, it would be necessary to issue scrip for fractions. Every holder of a number of shares not a multiple of five would receive scrip for a fraction of a share, carrying no voting rights and no dividends until assembled in amounts aggregating one full share. The aggregate annual dividend regularly paid on preferred stock (4% on \$70,000,000) is \$2,800,000, and the annual dividend paid on the common stock (8% on \$70,000,000) is \$5,600,000. The consolidated net earnings of the Reading Company and the Railway Company for the year 1920, after deducting interest, taxes and the preferred dividend, were approximately \$9,500,000. The effect of the

reduction of the capital stock proposed in the plan would be to reduce the aggregate amount payable by way of dividend to the preferred stock by \$140,000, and theoretically make a similar amount available for dividends on the common stock. It is improbable, however, that this increase in the amount theoretically available for distribution to the common stock would be sufficiently important to result in any actual increase in dividends to the common stock.

The foregoing figures are given merely for illustration. The defendant Reading Company does not know what the intervening common stockholders think the real market value of the coal property is. If, however, it be assumed that the market value is greater than the selling price, then the difference between the market value and the selling price is the amount which, in the view of the intervening common stockholders, should be deducted from the capital stock, preferred and common, of the Reading Company. Of that amount, whatever it is, one-half would fall upon the preferred stock. 4% of that one-half is the amount of the dividend which would be lost to the preferred stock under such proposal and therefore theoretically available for the common stock. It is not believed that upon any probable calculation of the market value of the coal stock, the amount so taken away from the preferred stockholders and transferred to the common stockholders in annual dividends would be of sufficient importance to counter-balance the disadvantage, even to the common stockholders themselves, of having the capital reduced.

Furthermore, from the point of view of taxation and from the point of view of rate and wage questions, the Reading Company ought rather to increase its capital stock than to decrease it. A decrease in the share capital and an attempted increase in the rate of dividend could only result in injuring the position of the company as towards taxing authorities, rate-making bodies, the travel-

ling public and its own employees. There is nothing in the situation to require it, and in the judgment of the Reading Company no class of stockholders would in the long run benefit by it.

VII.

The book surplus of the Reading Company will not be impaired. The book loss from the sale of the coal stock will be more than made up by taking up on the Reading Company's books in connection with the plan, the value of the railway property, as shown on the books of the Railway Company.

The Prosser Committee in their original petition, and again in their amended and supplemental petition, assert that the effect of carrying out the plan is to distribute to the preferred stockholders ratably per share with the common stockholders a surplus of upwards of \$33,000,000, accumulated by the Reading Company from the undivided net profits arising from its business, and that this surplus with the exception of a small part thereof, which the holders of the preferred stocks might assert could not be distributed to the common stock because dividends during the years in which it was earned were not fully paid on the preferred stocks, belongs under the circumstances here obtaining to the holders of the common stock, to the exclusion of the holders of both classes of preferred stock.

But the plan contemplates taking up on the books of the Reading Company the value of the Reading Company's investment in the railway as shown on the books of the Railway Company which will more than counterbalance what it will be necessary to write off its investment in the Coal Company under the plan. So that in fact the surplus of the Reading Company, after the consummation of the plan, will be much greater than \$33,000,000. An actual balance sheet of the Reading Company and of the Railway Company as of December 31, 1920, together with

a consolidated balance sheet of the Reading Company as it would have been at that date if the transactions contemplated by the plan had then been fully consummated, is hereto attached marked Exhibit G. An affidavit dated April 5, 1921, of the President of the Reading Company and the Railway Company in relation to such balance sheets is hereto attached marked Exhibit H.

The Prosser Committee in their amended and supplemental petition assert that the surplus to which they say the common stockholders are exclusively entitled is not merely the "surplus of upwards of \$33,000,000 accumulated by the defendant Reading Company from the undivided net profits arising from its business", but that to that surplus must be added "all of the surplus which will be created in said company by the merger of it with the Philadelphia & Reading Railway Company", and that such surplus is the exclusive property of the common stockholders. The allegation in the amended and supplemental petition is made somewhat clearer by the statement in a brief submitted in support of it, showing a balance sheet of the Reading Company after merger with the Railway Company but before divesting the coal properties, giving a surplus of \$76,994,672.

The position taken in the Prosser Committee's original petition that the surplus of \$33,000,000 accumulated by the defendant Reading Company from the undivided net profits arising from its business would be impaired by the consummation of the plan was in fact, as it could only be, sustained by ignoring the effect on the balance sheet of the Reading Company's merger with the Railway Company. Similarly the revised position of the Prosser Committee that the surplus which they say belongs to the common stockholders exclusively is not \$33,000,000 but \$78,000,000, can only be sustained by disregarding the effect on the Reading Company's surplus of the portion of the plan which provides for divesting the Reading Company of the coal properties.

Much is said by the intervening common stockholders about the order in which the various steps contemplated by the plan are to be carried out. The Reading Company has not intended to propose for the consideration of the court any particular order of events and has assumed that if the plan meets with the Court's approval it would be content to leave to the Reading Company the determination of the order. The plan is an entirety, one and indivisible, and must stand or fall as a whole.

The effect of the plan would be, not to decrease the surplus of the Reading Company, which is \$33,000,000, not \$78,000,000, but to increase it, because under the plan the Reading Company will take up on its books the value of its investment in the railway as now shown only on the books of the Railway Company; and, *on the Reading Company's books*, the increase of the value of its railway investment will more than counter-balance what it writes off on account of its investment in the coal properties.

The foregoing detailed discussion of the question of bookkeeping would seem necessary in order to make clear the actual situation. There can be no doubt that the books of the Reading Company after the consummation of the plan will show no impairment of capital or surplus, but an actual increase of surplus. This is purely a bookkeeping matter as presented by the intervening common stockholders. It has been necessary to rebut their view of the effect on the books because if in fact the effect of the plan on the books of the Reading Company would be to infringe upon its capital that of itself would constitute an objection to the plan worthy of serious consideration.

VIII.

The accumulated surplus of the Reading Company has been ploughed back into the property and is not in form available for current dividends.

Likewise, the surplus of the Railway Company is not,

and the greater part of it cannot at this late date be made into, earnings or profits of the Reading Company. No profit is being realized by the Reading Company in connection with the plan, and it is not useful to consider what would be the case if the Railway were being sold at an actual profit or if its surplus reached the Reading Company's treasury by way of dividend from the Railway Company. No such dividend has been or could properly be declared.

The Railway's surplus has been to a large extent ploughed back and become unavailable for dividends in fact and in law. The annual report of the Railway Company for the year ending June 30, 1910, contains the following statement:

"By command of the Interstate Commerce Commission, we are required to capitalize all betterments and additions which have been paid for out of income since June 30, 1907.

"The line drawn between renewals and repairs chargeable to Expense Account and Improvements is forcibly illustrated by the ruling on replacements of rails in tracks. If the old rail weighed sixty pounds and the new weighs ninety pounds, one-third of the cost of the new rail must be capitalized. The item on the assets side of the Balance Sheet, amounting to \$4,814,042.76 is the result of the Commission's order. With no counter entry on the liability side of the Balance Sheet, this sum would go to increase 'Profit and Loss.' Some of the railroad companies accept this result. It swells their surplus and has the appearance of wealth. But it seems to your management both misleading and dangerous. Increasing 'Profit and Loss' in this way will again tempt, as it has done in the past, the declaration of large stock dividends, thereby swelling capital on which earnings are to be made. To prevent misleading investors and stockholders, we have decided not to include this in 'Profit and Loss,' but to make the counter entry on the Balance Sheet: 'Appropriated surplus; expenditures on property since June 30, 1907, and charged as an asset.'"

This practice has been continued and the balance sheet of the Railway Company for December 31, 1920 (Exhibit F), shows the following items:

Additions to Property Through In-	
come and Surplus.....	\$53,451,156.59
Profit and Loss.....	10,276,169.32

While it is possible that the Railway Company might now be permitted to issue stocks or bonds for the amount of the appropriated surplus and declare them or their proceeds out as dividends, the fact remains that no such thing has been done or is contemplated and that the appropriated surplus has been ploughed back into the property and has become part of its corpus. It has been spent for the enlargement of the plant and for the increase of facilities. It has been so woven into the warp and woof of the structure as to have become an integral part of it.

Hereto attached marked Exhibit I is a statement giving the working assets and current liabilities of the Reading Company and of the Railway Company before the consummation of the plan, and, in a separate column, the working assets and current liabilities of the Reading Company assuming the consummation of the plan, all as of December 31, 1920. This statement shows clearly that the items carried as surplus on the books of the Reading Company and the Railway Company represent earnings turned back into the property and unavailable for dividends.

IX.

If, however, contrary to the views above expressed, the plan were to be regarded as involving a distribution of surplus, as is contended by the Prosser Committee, the preferred stockholders should not with fairness, and could not rightfully, be excluded from participation in it, because it would be neither a dividend nor a voluntary distribution of current surplus net profits.

The Reading Company is advised and believes that the holders of the preferred stock are entitled to a preference and are subject to a limitation of four per cent. per annum with respect to dividends from current profits of the Reading Company; but that they are entitled to no preference and are subject to no limitation with respect to distribution either of capital or of accumulations of profits which, for any reason, have become part of the capital or partake of the nature of capital and are not being detached therefrom by any voluntary act of the Company but only by a compulsion that makes such detachment a distribution of assets in partial liquidation of the corporation.

The charter of the Reading Company and its stock certificates constitute the contract between the Reading Company and the stockholders and between the stockholders *inter sese*, and, except as otherwise expressly provided in that contract, the holders of the various classes of stock of the company, first preferred, second preferred, and common, are, as the Reading Company is advised and believes, in all respects, and without limitation or preference, stockholders of the Reading Company and as such entitled to full voting power and to full participation in earnings and assets. That contract makes specific provision as to the creation of mortgages, increase of preferred stock, redemption of preferred stock and conversion of second preferred stock. It makes thoughtful and comprehensive provision with respect to the rights of the stockholders *inter sese* and as towards the company, as was to be expected in view of the importance of the Reading reorganization in 1896 and of the eminence of the counsel in charge of it. For the provisions with respect to the collateral matters above referred to reference is made to the copies of the stock certificates hereto annexed marked Exhibits C, D and E. The provisions with respect to dividends are of such importance that they are quoted at length:

From the First Preferred Stock Certificate:

The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

From the Second Preferred Stock Certificate:

The Second Preferred Stock is entitled to non-cumulative dividends, at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from

the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

From the Common Stock Certificate:

The Common Stock is subject to the prior rights of holders of all classes of Preferred Stock at any time outstanding, according to the preferences thereof. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

It may fairly be stated that under this contract, the surplus of the Reading Company falls into three parts:

(1) Current surplus net profits from the business of the particular year, excluding undivided net profits remaining from previous years.

Out of such surplus, dividends at the rate of but not exceeding 4% may be paid on the preferred stocks, and,

after providing therefor, dividends at such rate as the board may determine may be declared on the common stock, to the exclusion of the preferred.

(2) Surplus accumulated in years when 4% dividends were not paid on the preferred stock.

This is covered by the last sentence in the passage above quoted from each stock certificate, viz: "But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

(3) Surplus accumulated in years when 4% dividends were paid on the preferred stock but the dividends declared on the common stock did not exhaust the then current surplus.

The contract makes no express disposition of surplus so accumulated. Naturally, therefore, while part of the undisposed of property of the company, it is subject to the general rule which makes it the property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them either upon dissolution of the company or its final or partial liquidation; subject, however, to the right of the company, under equitable conditions, to eliminate the preferred stockholders as sharers therein by redeeming the preferred stock at par.

The situation thus created by the charter and the stock certificates of the Reading Company is orderly, well balanced, coherent and complete. One-half of the capital stock is preferred and one-half common. For the election of directors, and upon all other matters except as otherwise expressly provided in the stock certificates, preferred and common stock have equal voting powers. Under the charter (Exhibit B) and also at common law as interpreted by the Courts of Pennsylvania, in the case of any increase of capital stock, preferred or common, whether

by way of dividend or sale, the holders of the capital stock, preferred and common, would have the preemptive right to participate therein *pro rata* without discrimination or preference, thus enabling them to protect their relative voting power and interest in the assets. Current earnings are appropriated, first to the payment of 4% dividends on the preferred stock, and thereafter to the payment of such dividends, if any, as the Board of Directors may determine, to the holders of the common stock. In respect to current earnings, the preferred stock has a preference up to, but not exceeding, 4% to the exclusion of the common stock. Preferred stock has, however, no right to receive 4% dividends from current earnings, and the decision of the Board of Directors not to pay any dividends at all or to pay dividends of less than 4% on preferred stock is conclusive and binding upon the preferred stock. This right was exercised over a period of years after the reorganization in 1896. After the payment of 4% dividends on the preferred stock from current earnings, the common stock has a right to receive dividends to such amount as the Board of Directors may declare from current earnings to the exclusion of the preferred stock. But the common stock has not right to receive any dividends at all from current earnings unless the Board of Directors shall declare them, nor in any greater amount than the Board shall legally declare, and the decision of the Board of Directors as to the amount of these earnings which, after the payment of the 4% dividends on the preferred stock, shall be declared as dividends to the common stock, is also conclusive and binding upon the common stock. Just as the inchoate right of the preferred stock to receive 4% dividends in preference to the common stock is of no avail with respect to those years from the current earnings of which such dividends are not in fact declared, so the inchoate right of the common stock to receive dividends from any current earnings, remaining after payment of the 4% preferred stock divi-

dends, is of no avail with respect to those years from the current earnings of which dividends are not in fact declared to them.

In both cases the decision of the Board of Directors is final and binding, and the surplus net profits, of any year, which the Board of Directors has not determined to declare out for dividends, become part of the general assets of the Company which, in the case of any extraordinary distribution in the nature of a partial liquidation of the company, are—as between preferred and common stockholders—subject to no preference but are distributable to them share and share alike, without discrimination and without priority or limitation of right.

As to this the determination of the Board of Directors is conclusive, and whatever part of the current surplus the Board of Directors determines shall be retained as necessary for the conduct of the Company's business or turned back into the property for its betterment or improvement or added to its "plant" in the enlargement of those facilities in which the Company's capital is invested, becomes, by their determination and because of their determination, segregated for capital uses—uses inconsistent with a use for dividend purposes and not subject to the rules applicable to available dividend funds—and its status so lawfully created and with such a wise and prudent purpose cannot be changed without the specific and explicit determination of the Board that it shall be so changed.

It cannot be fairly contended that, under the compulsion of a power superior to the Company, forcing the latter to part with a material and important part of its "plant" or its assets segregated for and devoted to capital uses, there has been, or is intended to be, either in fact or in law, any such determination by the Board as is required to change that status.

It was doubtless not thought probable that such surplus so reserved and so segregated would ever have to be made the subject matter of a dividend; but it was, how-

ever, well known and clearly understood by all that, in the case of dissolution or liquidation of the company, the assets belonged to the stockholders, preferred and common, share and share alike; and it is only a natural and plain corollary of this that, in the event—deemed so unlikely—of some uncurrent distribution not in the nature of a dividend, not declared as a dividend and compulsorily made in spite of a determination not to declare a dividend, the assets so parted with, being assets which, in the case of a liquidation or dissolution of the company, would by plain and explicit provision go to the stockholders, preferred and common, share and share alike, should go precisely the same way in case of a partial liquidation even though no dissolution occurred. The protection thus accorded to the preferred stockholders against having accumulated assets in such event diverted to the common stockholders exclusively, was accompanied by a provision well calculated to prevent being turned to their undue profit what was intended for their protection only; viz: provision permitting the Company to redeem the preferred stock for cash at par.

The Reading Company does not wish to prejudice or prejudge the rights of the stockholders, preferred or common, as to the present situation or any future situation which may arise in the conduct of the affairs of the Company. It does assert, however, with confidence that the foregoing interpretation of the contract is properly applicable to the situation presented by the present plan, which plan is designed and intended to carry into effect the mandate of the Supreme Court of the United States requiring at least a partial liquidation of the assets of the Reading Company to the extent that it requires it to dispose of its interest in the stock of the Coal Company.

X.

The application to the New York Stock Exchange for listing the stock of Reading Company (Listing Statements, New York Stock Exchange, Vol. 7, A2986 Oct. 15,

1904) contains the following statement declaratory of the common law :

"The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets."

The Supreme Court directed the dissolution of the combination between the Railway Company and the Coal Company. The instrument of that combination was the Reading Company, a holding company specially chartered under the laws of Pennsylvania. The plan, if carried into effect, would dissolve the combination and deprive the Reading Company of its extraordinary powers and of its coal properties. It has been contended with much force that the preferred stockholders cannot under these circumstances be compelled to continue their investment in any part of the enterprise subject to the 4% limitation and that under the circumstances created by the decree in this case the proper course would be to distribute the stocks of both the Railway and Coal Companies, which would put the preferred stockholders in the position of common stockholders of the Railway Company, and would relieve them of the 4% limitation on their participation in current earnings. As far as the Reading Company is informed, they have acquiesced in the plan, doubtless believing it to be a fair compromise and believing that, because it leaves existing outstanding securities undisturbed, it will best promote in the long run the interests of all concerned. The Reading Board is informed and believes that it could not properly or lawfully go further and exclude the preferred stockholders from participation in the purchase of the coal property.

Not only is it proper to permit the preferred stockholders to participate in the purchase, but they have a right *not* to be excluded unless redeemed. They share a right with the common stock to purchase these assets, which

constitute a part of the original enterprise, unless they are sold at public or private sale at the best price obtainable. The enterprise in which they originally embarked their capital was that of the Reading Company as the owner of both the railroad and coal properties. They hazarded their capital in the joint enterprise and accepted the limitation upon their participation in profits in reliance upon the security afforded to them by the Reading Company's capital investment in both properties. If it is true that the Reading Company is disposing of the coal stock for less than its market value, and they are excluded from participation in the purchase, they could legitimately object to being compelled to continue their investment in the railroad property, subject to the limitation of 4%, after being deprived of the security afforded by the investment in the coal property, without the Reading Company obtaining its full equivalent. Preferred stock cannot be deprived of the security afforded by the Reading Company's entire assets except by the declaration of a dividend from profits. No profit, but on the contrary a loss, results to the Reading Company on the transaction. The Reading Board has not declared any dividend and the facts do not justify the declaration of an extraordinary dividend.

XI.

Defendant Reading Company, holding the foregoing views, which lead it to the conclusion that it is unnecessary to determine the answer to the question, presented on behalf of intervening common stockholders on the one hand and preferred stockholders on the other, concerning the rights of the preferred and common stockholders in respect to dividends from accumulated surplus—a question which it has never been called upon to decide for it has never drawn upon accumulated surplus for dividends upon the common stock—and believing that the Reading

Company and its board, representing as they do all classes of stockholders of the company, should not, unnecessarily, express an opinion upon this question concerning the basic contract between the stockholders, refrains in this answer from any such expression, suggesting merely that, if the Court should grant the petition to intervene of any stockholders, it grant the petitions of all, to the end that the conflicting views of stockholders upon this important though, as defendant Reading Company is advised and believes, irrelevant question may be before the Court.

XII.

This defendant, on information and belief, denies each and every allegation of said petitions, insofar as such allegations are inconsistent with the statements and allegations herein contained.

XIII.

Defendant Reading Company has not undertaken in this answer to deal at length with the various modifications of the old plan or the new plans submitted on behalf of security holders, believing that it will be necessary first to learn the decision of this Honorable Court concerning the three principal questions presented by them, which are as follows:

(1) the question as between the preferred and common stockholders discussed at length in this answer;

(2) whether the Coal Company's stock should be sold free from the lien of the mortgage;

(3) whether the Reading Company should offer a premium of 10% to the General Mortgage bondholders for release of the Coal Company's property from the lien of the mortgage.

Concerning questions (2) and (3) the Reading Company expresses no opinion. The provisions of the plan in-

volving the proceedings as to which these questions arise were inserted primarily to satisfy the government and this Honorable Court. If the Court should determine that either or both of these proceedings is unnecessary, the defendant Reading Company respectfully requests an opportunity to present a modified plan in the light of such determination of the Court.

XIV.

By way of cross petition to said petitions this defendant respectfully shows to the Court:

1. If leave be granted to any of said petitioners to intervene, the Reading Company respectfully petitions this Honorable Court to grant leave to intervene also, without other relief, to the Preferred Stockholders' Committee and William B. Kurtz and any other holders of stock, preferred or common, or both, who may have asked leave to intervene, to the end that the Court may be fully informed concerning the conflicting views of the Reading Company's stockholders.

2. In order to prevent multiplicity of suits and to insure the carrying out of the Plan submitted to the Court, or such other plan as the Court may approve, it is respectfully urged that if said petitioners are allowed to intervene in this cause, such intervention be permitted only on condition that such intervention be made on behalf of the petitioners and/or the stockholders represented by the petitioners and all others similarly situated, to the end that the decision of this Court in this cause may be binding on all stockholders of the defendant similarly situated, whether or not such stockholders shall actually intervene herein.

3. This defendant believes that this Court and this defendant should be informed as to the names of stockholders and amount of stock from time to time represented by the

Committees which may be allowed to intervene. Accordingly, this defendant respectfully suggests that all such Committees be directed by this Court to file with the Court:

(1) a certified copy of any agreement or other authority under which such Committee is constituted or acting;

(2) certified lists of the names of all stockholders represented by such Committee and the number of shares held by each, with dates, showing when their proxies were received by such Committee.

WHEREFORE this defendant respectfully prays:

(1) that if the prayer of any petitioner for leave to intervene herein be granted, it be granted only on the terms and subject to the conditions set out in XIV hereof and on such further terms and conditions as to your Honorable Court may seem just and proper;

(2) that all other prayers of said petitions be denied;

(3) that if this Honorable Court should determine that the stock of the Coal Company need not be released from the mortgage or that the Reading Company need not offer a premium of 10% to the holders of General Mortgage bonds for the release of the property of the Coal Company, defendant be granted time sufficient to formulate a modification of the plan in accordance with such determination of this Honorable Court;

(4) that the plan submitted to the Court on February 14, 1921, be approved as submitted, subject to such modifications as may be presented to and approved by this Honorable Court in the event referred to in the last preceding paragraph (3), and that the Court retain jurisdiction of this cause with directions to the defendant Reading Company to make report to this Court from

time to time at such intervals as this Court may determine of the progress made in executing the plan;

(5) that this defendant have such other and further relief in the premises as the nature and circumstances of the case may require and as to this Court shall seem proper.

Dated, April 5th, 1921.

READING COMPANY,
by CHARLES HEEBNER
General Counsel.

WM. CLARKE MASON
Solicitor.

R. C. LEFFINGWELL
Counsel.

Exhibit A

READING COMPANY
READING TERMINAL
PHILADELPHIA

FEBRUARY 14, 1921.

TO THE STOCKHOLDERS OF READING COMPANY:

This Company has submitted to the United States District Court for the Eastern District of Pennsylvania, pursuant to its order, a plan for the termination of the Reading Company's control by stock ownership of Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company (hereinafter called the Coal Company), and Central Railroad Company of New Jersey. Enclosed herewith for your information are a copy of the plan, a copy of the counter-proposal by the United

States to paragraph eight thereof and a copy of the order of the Court relating thereto.

The main features of the plan are:

(a) The sale of certificates of interest (described in the plan) in the stock of the Coal Company to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000—an amount which is equal to \$2.00 for each \$50 share of Reading Company stock.

(b) Merger of the Philadelphia & Reading Railway Company into the Reading Company; the Reading Company thereafter to have only the powers appropriate for a railroad corporation of Pennsylvania and to own the railroad and property of the Philadelphia & Reading Railway Company, and in addition the railroad equipment, railroad stocks and bonds, and all property not otherwise disposed of under the plan, now owned by the Reading Company.

(c) The transfer of the stock of Central Railroad Company of New Jersey now owned by Reading Company to be deferred pending the grouping of railroads by the Interstate Commerce Commission, but subject to the further order of the Court.

(d) The early sale by the Central Railroad Company of New Jersey of the stock of the Lehigh & Wilkes-Barre Coal Company.

In order to carry out the separation of the Reading Company's railroad and coal properties it is necessary to arrange for a general financial settlement between the Reading Company and the Coal Company. There are outstanding \$96,524,000 of General Mortgage 4 per cent. bonds which are the joint obligation of the Reading Company and the Coal Company, and there are inter-company claims to be adjusted. As a step in compliance with the

decree of the Supreme Court, which requires a separation of interests, and in order that there may be but one principal debtor instead of the continuance of the present joint principal obligation, the Reading Company will assume the General Mortgage, and will agree to save the Coal Company harmless from liability on the bonds. Thereupon the Reading Company will become the principal debtor and, except as released as hereafter provided, the Coal Company and its property will stand as surety for the payment of the bonds. The Coal Company will pay the Reading Company \$10,000,000 in cash or current assets, and \$25,000,000 in 4 per cent. mortgage bonds of the Coal Company. These sums are in addition to the \$5,600,000 to be derived from the sale of the stock of the Coal Company. General releases of all claims and liabilities between the two companies will be exchanged. The Reading Company will offer the holders of General Mortgage bonds a premium of 10 per cent. for the release of the coal properties and their agreement, if a sufficient number of bonds assent to exchange General Mortgage bonds for its new refunding mortgage bonds to be hereafter created.

The Board of Directors believe that this plan, while fully complying with the decisions of the Supreme Court and the order of the District Court in separating the railroad and coal properties, involves a minimum disturbance of existing securities. The shares of stock, the General Mortgage bonds (unless and except to the extent that their holders elect to accept the above offer), and other bonds of or guaranteed by the Reading Company, will remain undisturbed, while the stockholders of the Reading Company, preferred and common, will have an opportunity to participate ratably in the purchase of the Coal Company stock, retaining their interest unaltered in the remaining properties.

This letter is sent to you for your information as to the general character of the action contemplated. You

will, of course, understand that pending consideration of it by the court and necessary further proceedings, the plan is wholly tentative.

By order of the Board of Directors.

AGNEW T. DICE,
President.

Exhibit B

Reading Company was originally incorporated as Excelsior Enterprise Company by the legislature of Pennsylvania by the act of 24 May 1871, P. L. 1089. The name was later changed to National Company and finally in 1896 to Reading Company. The original act of incorporation is as follows:

"No. 983

AN ACT

To incorporate the Excelsior Enterprise Company, with power to purchase, improve, use and dispose of property, to aid contractors and others, and for other purposes.

SECTION 1. Be it enacted by the Senate and House of Representatives of the Commonwealth of Pennsylvania in General Assembly met, and it is hereby enacted by the authority of the same, That Charles Cook, John Clayton, Edward M'Dowall, J. M'Clogan, J. H. Graham and Joseph Keating, their associates, successors and assigns, be and they are hereby authorized and empowered to form and be a body corporate, to be known by the name, style and title of the Excelsior Enterprise Company, and by that name, style and title shall have perpetual succession, and exercise and enjoy all the privileges incident to a corporation.

SECTION 2. The said corporation shall also have, enjoy and exercise the same rights, powers, privileges franchises and immunities as are conferred in and by an act of assembly of the Commonwealth of Pennsylvania, entitled 'An Act to incorporate the Pennsylvania Company,' approved the seventh day of April, Anno Domini one thousand eight hundred and seventy; and also have, exercise and enjoy the rights, privileges, franchises and immunities granted in and by any existing supplements to the charter of the said, the Pennsylvania Company, as if the same were herein specially and particularly set forth.

SECTION 3. That the stockholders of the said company, by and with the advice and consent of the holders of two-thirds of the shares of stock, be and they are hereby authorized to change the name and title of the said company, and to designate the location of its general office; which changes shall be valid after the filing of a certificate in the office of the secretary of the commonwealth, signed by the president and secretary and attested by the seal of the said company.

JAMES H. WEBB,

Speaker of the House of Representatives.

WILLIAM A. WALLACE,

Speaker of the Senate.

APPROVED—The twenty-fourth day of May, Anno Domini one thousand eight hundred and seventy-one.

JNO. W. GEARY."

Pennsylvania Company was incorporated by the following act:

"AN ACT

TO INCORPORATE THE PENNSYLVANIA COMPANY.

"SECTION 1. Be it enacted by the Senate and House of Representatives of the Commonwealth of Pennsylvania in General Assembly met, and it is hereby enacted by

authority of the same, that Andrew Howard, J. S. Swartz, G. B. Edwards, J. D. Welsh, and J. T. Malin, their associates, successors and assigns, or a majority of them, be and they hereby are authorized to form and be a body corporate, to be known as the Pennsylvania Company, and by that name, style and title, shall have perpetual succession, and all the privileges, franchises, and immunities incident to a corporation, may sue and be sued, implead and be impleaded, complain and defend, in all courts of law, and equity, of record and otherwise, may purchase, receive, hold and enjoy, to them, their successors and assigns, all such lands, tenements, leasehold estates and hereditaments, goods and chattels, securities and estates, real, personal and mixed, of what kind and quality soever, as may be necessary to erect depots, engine houses, tracks, shops and other purposes of the said corporation, as hereafter defined by the second section of this act, and the same from time to time may sell, convey, mortgage, encumber, charge, pledge, grant, lease, sub-lease, alien and dispose of and also make and have a common seal and the same to alter and renew at pleasure, and ordain, establish and put in execution such by-laws or ordinances, rules and regulations as may be necessary or convenient for the government of the said corporation, and not being contrary to the constitution and laws of this commonwealth, and generally may do all and singular the matters and things which to them shall appertain to do for the well-being of the said corporation and the management and ordering of the affairs and business of the same; Provided, That nothing herein contained shall be so construed as to give to the said corporation any banking privileges or franchises, or the privileges of issuing their obligations as money.

SECTION 2. That the corporation hereby created shall have power to contract with any person or persons, firms,

corporations or any other party, howsoever formed, existing or that may hereafter exist, in any way that said parties or any of them may have authority to do, to build, construct, maintain or manage any work or works, public or private, which may tend or be designed to improve, increase, facilitate or develop trade, travel or the transportation and conveyance of freight, live stock, passengers and any other traffic, by land or water, from or to any part of the United States or the territories thereof; and the said company shall also have power and authority to supply or furnish all needful material, labor, implements, instruments and fixtures of any and every kind whatsoever, on such terms and conditions as may be agreed upon between the parties respectively; and also to purchase, erect, construct, maintain or conduct, in its own name and for its own benefit, or otherwise, any such work, public or private, as they may by law be authorized to do, (including also herein lines for telegraphic communication,) and to aid, co-operate and unite with any other company, person or firm in so doing.

SECTION 3. The Company hereby created shall also have the power to make purchases and sales of or investments in the bonds and securities of other companies, and to make advances of money and of credit to other companies, and to aid in like manner contractors and manufacturers; and to receive and hold, on deposit or as collateral, or otherwise, any estate or property, real or personal, including the notes, obligations and accounts of individuals and companies, and the same to purchase, collect, adjust and settle, and also to pledge, sell and dispose thereof, on such terms as may be agreed on between them and the parties contracting with them; and also to endorse and guarantee the payment of the bonds and the performance of the obligations of other corporations, firms and individuals, and to assume, become responsible for, execute and carry out any contracts, leases or subleases made by

any company to or with any other company or companies, individuals or firms whatsoever.

SECTION 4. The company hereby created shall also have power to enter upon and occupy the lands of individuals or of companies, on making payment therefor or giving security according to law, for the purpose of erecting, constructing, maintaining or managing any public work, such as is provided for or mentioned in the second section of this act, and to construct and erect such works thereon, and also such buildings, improvements, structures, roads or fixtures as may be necessary or convenient for the purpose of said company under the powers herein granted; and to purchase, make, use, and maintain any works or improvements connected or intended to be connected with the works of the said company; and to merge or consolidate, or unite with the said company the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon; and to fix and regulate the tolls or charges to be charged or demanded for any freight, property or passengers travelling or passing over any improvement erected, managed or owned by the said company, or on any merchandise or property transported over any road whatever by the said company and to make, from time to time, dividends from the profits made by said company; the several railroads managed by the said company shall continue taxable, as heretofore, in proportion to their length within this State respectively; and the said Pennsylvania Company shall be taxable only on the proportions of dividends on its capital stock and upon net earnings or income, only in proportion to the amount actually carried by it within the State of Pennsylvania, and all its earnings or income derived from its business beyond the limits of this commonwealth shall not be liable for taxation.

SECTION 5. The capital stock of said company shall consist of two thousand shares of the value of fifty dollars each, being one hundred thousand dollars, and with the privilege of increasing the same, by a vote of the holders of a majority of the stock present at any annual or special meeting, to such an amount as they may from time to time deem needful, and the corporators, or a majority of them, named in the first section of this act, shall have power to open books for subscriptions at such times and places as they may deem expedient; and when not less than one thousand shares shall have been subscribed, and twenty per centum thereon shall have been paid in, the shareholders may elect not less than three nor more than nine directors to serve until the next annual election, or until their successors shall be duly elected and qualified; and the directors so elected may and they are hereby authorized and empowered to have and to exercise, in the name and in the behalf of the company, all the rights and privileges which are intended to be hereby given, subject only to such liabilities as other shareholders are subject to, which liabilities are no more than for the payment, to the company, of the sums due or to become due on the shares held by them; and should the capital stock at any time be increased, the stockholders, at the time of such increase, shall be entitled to a *pro rata* share of such increase, upon the payment of the instalments thereon duly called for; and whenever an increase of capital stock is made a certificate thereof, duly executed under the corporate seal of the company, and signed by the president and secretary, shall be filed with the auditor general before the same shall be deemed to be valid.

SECTION 6. The principal office of the said company shall be in the city of Pittsburgh; but the directors, under such rules and regulations as they may prescribe, may establish branches or agencies in other parts of the State,

or elsewhere; all of the directors of said company shall be citizens of the United States, and reside therein.

SECTION 7. The directors shall be elected annually by the stockholders on the first Tuesday of June of each year; and they shall elect from their number, at the first meeting of the board after their election, a president, and shall also have power to elect from their number, or otherwise, a vice-president, a treasurer and secretary, and such other officers, clerks and agents as the business of the company may require; all elections for directors shall be by ballot, and every stockholder shall be entitled to one vote for each share of stock held by him; but no person shall be eligible as director who is not a stockholder to the amount of ten shares; at the annual or special meetings a quorum shall consist of stockholders owning at least one-half of the capital stock.

SECTION 8. Ten days' notice shall be given, by publication in two newspapers published in the city of Pittsburgh, of the time and place of the annual election; which election shall be conducted by three stockholders, one of whom shall act as judge, and the other two as inspectors.

SECTION 9. The board of directors shall make all by-laws necessary for conducting the business of the company, which by-laws shall at all times be accessible to persons transacting business with them; the said directors shall have power, by a vote of a majority of their number, at any meeting of the board, to change the name of the said corporation; and by any new name, thus adopted, upon filing with the secretary of the commonwealth and the auditor general a truly certified certificate, the said company shall have, hold and enjoy all the rights, powers, privileges and immunities hereby granted; the directors shall have power to require payment of the amount remaining unpaid on the stock of said company at such times and in such proportions as they shall think proper;

the said assessment to be made as the by-laws of said company shall direct.

ELISHA W. DAVIS,
Speaker of the House of Representatives, pro tem.

CHARLES H. STINSON,
Speaker of the Senate.

Approved the seventh day of April, Anno Domini, 1870.

JNO. W. GEARY.

The following supplemental act was passed and accepted by Pennsylvania Company prior to May 24, 1871, the date of the act incorporating the Reading Company.

AN ACT.

Supplementary to an Act, entitled "An Act to incorporate the Pennsylvania Company", approved the 7th day of April, Anno Domini 1870, authorizing the issue of common or preferred stock, and authorizing the sale or disposal thereof by the company.

SECTION 1. Be it enacted by the Senate and House of Representatives of the Commonwealth of Pennsylvania in General Assembly met, and it is hereby enacted by the authority of the same, That the capital stock of said company as authorized by said act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said company may from time to time determine; and the said company are hereby authorized and empowered to issue said stock, or any portion thereof, in payment of any debt or liability incurred in the purchase of any property, or they may sell or dispose of any portion of said common or preferred stock, on such terms and conditions as the company may agree upon with any party or parties, company or companies, or in the doing of any other act au-

thorized by the provisions of the act to which this a supplement.

JAMES H. WEBB,
Speaker of the House of Representatives.

WILLIAM A. WALLACE,
Speaker of the Senate.

Approved the 18th day of February, Anno Domini,
1871.

JOHN W. GEARY.

Exhibit C

Certificate of First Preferred Stock printed as part of Exhibit C to petition of Continental Insurance Company *et al.*, *supra*, pp. 88, 89.

Exhibit D

Certificate of Second Preferred Stock printed as part of Exhibit C to petition of Continental Insurance Company *et al.*, *supra*, pp. 90, 91.

Exhibit E

Certificate of Common Stock printed as part of Exhibit C to petition of Continental Insurance Co. *et al.*, *supra*, pp. 92, 93.

Exhibit F

THE PHILADELPHIA AND READING COAL AND IRON COMPANY
TENTATIVE GENERAL BALANCE SHEET, DECEMBER 31, 1920.

DR.

CR.

AMOUNT		TOTAL	AMOUNT		TOTAL
CAPITAL ACCOUNTS			CAPITAL ACCOUNTS		
Coal Lands.....	\$43,183,094.88		P. & R. Collateral Sinking Fund		
Timber Lands.....	830,678.39		Loan, 1892-1932.....		\$870,000.00
New York and Eastern Depots....	892,834.64		Capital Stock.....		8,000,000.00
Western Yards and Depots.....	2,012,038.71		Reading Company.....		69,357,017.99
Miners and Other Houses.....	1,175,077.26				
Pottsville Shops, Real Estate and Improvements	461,104.92				
Storage Yards and Washeries....	675,107.78				
Other Real Estate.....	427,282.19				
Improvements and Equipments at Collieries	14,894,210.91				
Stocks and Bonds of and Loans to Companies Controlled	9,920,260.85				
		\$74,471,690.53			
Stocks, Bonds and Mortgages.....		490,384.50			
1st U. S. Liberty Loan Bonds Con- verted	300.00		CURRENT LIABILITIES		
2nd U. S. Liberty Loan Bonds Con- verted	1,903,500.00		Pay Rolls and Vouchers.....	\$2,892,039.19	
3rd U. S. Liberty Loan Bonds....	1,484,969.34		Due for Coal Purchased.....	36,344.08	
4th U. S. Liberty Loan Bonds....	3,003,550.00		Due for Royalty on Coal Mined....	58,565.45	
2nd, 3rd and 4th U. S. Liberty Loan Bonds purchased for sale to em- ployes, less collections on ac- count	114,635.92		Freight and Tolls Due Foreign Roads	17,680.74	
		6,506,955.26	Companies and Individuals.....	397,483.56	
			Interest Due and Uncollected.....	280.00	
			Interest and Taxes Accrued.....	1,312,652.26	
					4,715,045.28
CURRENT ASSETS					
Cash	8,245,174.27		Miners' Beneficial Fund.....		76,752.25
Bills Receivable.....	9,222.76		Workmen's Compensation Fund...		1,454,006.77
Coal Accounts.....	8,015,094.29		Contingent Fund.....		1,608,203.24
Rent Accounts.....	46,735.48				
Companies and Individuals.....	4,768,626.72				
Coal on Hand.....	1,727,565.43				
Supplies and Materials on Hand..	3,925,492.43				
Accrued Interest on Bonds owned by Company.....	65,515.99				
		26,803,427.37			
Depletion of Coal Lands' Fund In-					

vestment:—		
Cash	8,517.83	
Securities	2,031,471.75	
		2,039,989.58
Workmen's Compensation Fund In-		
vestment:—		
Cash	14,075.72	
Securities	1,439,931.05	
		1,454,006.77
		\$111,766,454.01

Profit and Loss to Dec. 31, 1919...	19,013,206.09	
Profit and Loss Jan. 1 to Dec. 31,		
1920	6,672,222.39	
		25,685,428.48
		\$111,766,454.01

THE PHILADELPHIA AND READING COAL AND IRON COMPANY

INCOME ACCOUNTS FOR THE YEARS ENDING DECEMBER 31, 1916, 1917, 1918, 1919, AND TENTATIVE INCOME ACCOUNT FOR 1920.

RECEIPTS	1916	1917	1918	1919	1920 (Tentative)
Coal Sales (Anthracite).....	\$40,673,462.86	\$48,054,942.41	\$54,218,911.43	\$58,048,078.31	.....
Coal Sales (Bituminous).....	1,423,276.83	1,092,961.62	1,292,089.02	1,209,892.59	.....
Coal Rents.....	324,112.57	273,881.55	260,280.81	239,130.52	.....
House and Land Rents.....	143,188.13	151,197.54	153,086.40	174,944.28	.....
Interest and Dividends.....	66,649.99	92,216.79	303,701.09	373,248.05	.....
Miscellaneous.....	70,370.96	231,708.40	158,870.20	59,931.68	.....
Total Receipts.....	\$42,701,061.34	\$49,896,908.31	\$56,386,938.95	\$60,105,225.43	\$75,208,259.70
EXPENSES					
Mining Coal and Repairs.....	\$22,384,972.94	\$27,851,557.26	\$37,798,861.50	\$43,616,852.85	.....
Improvements at Collieries.....	867,664.60	1,505,506.71	1,455,911.97	1,316,612.96	.....
Coal Purchased (Bituminous).....	1,265,104.81	982,206.32	1,143,433.51	1,199,657.18	.....
Royalty of Leased Collieries.....	625,042.15	823,090.36	908,302.77	817,154.90	.....
Transportation of Coal by Rail.....	5,848,808.15	5,935,059.54	7,035,979.97	6,420,120.59	.....
Transportation of Coal by Water.....	978,201.32	882,701.12	400,327.86	333,553.09	.....
Handling Coal at Depots.....	443,363.28	421,988.95	395,667.01	604,627.41	.....
Taxes on Coal Lands and Improvements.....	714,200.00	735,972.68	754,734.16	1,143,969.92	.....
Improvements and Repairs of Houses.....	43,195.92	43,967.59	71,383.33	83,268.37	.....
Damages Account Coal Dirt.....	8,770.87	16,849.95	1,222.64	1,018.21	.....
Workmen's Compensation Fund.....	474,253.92	523,072.46	497,689.36	489,207.05	.....
Contingent Fund.....	718,806.27	1,002,745.30	178,089.15	.....	.....
Depletion of Coal Lands Fund.....	.....	451,339.06	453,304.87	406,485.60	.....
All Other Expenses.....	1,293,969.89	1,646,612.15	1,778,122.81	2,052,141.50	.....
Coal Sold from Stock.....	3,934,952.18	492,272.17	.....	.....	.....
Less Coal Added to Stock.....	\$39,601,306.30	\$43,308,941.62	\$52,873,030.91	\$58,484,669.63	\$67,826,038.37
Total Expenses.....	\$39,601,306.30	\$43,308,941.62	\$51,746,776.75	\$57,233,953.25	\$67,826,038.37
Profit in Operating.....	\$3,099,755.04	\$6,587,966.69	\$4,640,162.20	\$2,871,272.18	\$7,382,221.33
Adjustments of Royalty, Inventory, etc.....	.....	.....	.....	232,112.83	260,009.98
				\$3,103,385.01	\$7,642,231.31
Fixed Charges, Taxes and Interest.....	\$207,308.09	\$1,151,333.69	\$480,000.00	\$236,648.16	\$970,008.92
Taxes on Coal Lands and Improvements Previous Years.....	66,159.51	.....	.....	.....	.....
Judgment Paid Bellas Estate.....	362,497.14	.....	.....	.....	.....
	\$635,964.74	\$1,151,333.69	\$480,000.00	\$236,648.16	\$970,008.92
Profit.....	\$2,463,790.30	\$5,436,633.00	\$4,160,162.20	\$2,866,736.85	\$6,672,222.39
Profit of Previous Years.....	4,085,883.74	6,549,674.04	11,986,307.04	16,146,469.24	19,013,206.09
Balance to Credit of Profit and Loss Account.....	\$6,549,674.04	\$11,986,307.04	\$16,146,469.24	\$19,013,206.09	\$25,685,428.48

Exhibit 6

Actual balance sheets of the Reading Company and of the Philadelphia & Reading Railway Company as of December 31, 1920, together with a consolidated balance sheet of the Reading Company as it would have been at that date if the transactions contemplated by the plan had then been fully consummated.

ASSETS

	READING COMPANY	P. & R. RY. CO.	ELIMINATIONS	CONSOLIDATED
<i>Investments:</i>				
Road and Real Estate.....	16,382,479.08	128,319,306.14	.....	144,701,785.22
Rolling Equipment.....	50,655,195.56	.....	.....	50,655,195.56
Floating Equipment.....	5,223,593.89	.....	.....	5,223,593.89
Ferry Boats "Haddon Heights" and "Ventnor".....	632,928.04	.....	.....	632,928.04
Leased Equipment.....	20,467,063.55	.....	.....	20,467,063.55
Improvements on Leased Railway Property.....	.....	21,875,969.04	.....	21,875,969.04
Deposits in Lieu of Property Sold.....	.....	274.50	.....	274.50
Miscellaneous Physical Property.....	.....	1,565,810.77	.....	1,565,810.77
Investments in Affiliated Companies:				
(a) Stocks	101,619,084.39	170,200.00	50,481,700.00	51,307,584.39
(b) Bonds	41,082,315.22	.....	20,207,272.70	20,875,042.52
(c) Advances	11,383,931.04	2,113,281.52	118,709.46	13,378,503.10
Total Investments in Affiliated Companies....	154,085,330.65	2,283,481.52	70,807,682.16	85,561,130.01
Other Investments:				
(a) Stocks	2,445,051.51	15,283.89	.....	2,460,335.40
(b) Bonds	3,507,305.56	2,200.00	Add 25,000,000.00	28,509,505.56
Total Other Investments.....	5,952,357.07	17,483.89	Add 25,000,000.00	30,969,840.96
Mortgages and Ground Rents.....	253,016.66	.....	20,500.00	232,516.66
Total Investments.....	253,621,964.50	154,062,325.86	45,828,182.16	361,856,108.20
Due from Philadelphia and Reading Coal and Iron Co.	69,357,017.99	.....	69,357,017.99	.....
<i>Current Assets:</i>				
Cash	2,894,455.75	1,876,792.51	Add 6,228,300.00	10,999,548.26
Special Deposits.....	59,040.00	815.00	.....	59,855.00
Loans and Bills Receivable.....	100,000.00	16,789.30	.....	116,789.30
Net Balance Receivable from Agents and Conductors .....	.....	3,180,128.93	.....	3,180,128.93
Miscellaneous Accounts Receivable.....	1,394,101.61	2,765,474.44	.....	4,159,576.05
Accrued Interest and Dividends.....	1,148,279.85	.....	.....	1,148,279.85
Materials and Supplies.....	.....	9,502,299.56	.....	9,502,299.56
Rents Receivable.....	37,114.64	20,966.14	.....	58,080.78
Philadelphia & Reading Railway Co.....	747,415.79	.....	745,349.05	2,066.74
Other Current Assets.....	635,585.70	1,917,439.29	.....	2,553,024.99
Total Current Assets.....	7,015,993.34	19,280,705.17	Add 5,482,950.95	31,779,649.46
<i>Deferred Assets:</i>				
Working Fund Advances.....	.....	98,294.37	.....	98,294.37
Insurance and Other Funds.....	.....	1,040,332.08	.....	1,040,332.08
U. S. Government.....	.....	41,997,484.94	.....	41,997,484.94
Total Deferred Assets.....	.....	43,136,111.39	.....	43,136,111.39
<i>Unadjusted Debits:</i>				
Rents and Insurance Premiums Paid in Advance.....	.....	1,523.86	.....	1,523.86
Other Unadjusted Debits.....	8,215.02	3,293,542.83	.....	3,301,757.85
Total Unadjusted Debits.....	8,215.02	3,295,066.69	.....	3,303,281.71
Securities Issued or Assumed—Unpledged.....	.....	2,782,000.00	.....	2,782,000.00
TOTAL	330,033,190.85	222,556,209.11	109,702,249.20	442,887,150.76

LIABILITIES

<i>Capital Stock:</i>				
Preferred.....	28,000,000.00	.....	.....	28,000,000.00

	140,000,000.00	42,481,700.00	42,481,700.00	140,000,000.00
<i>Funded Debt:</i>				
Equipment Trust Obligations.....	9,450,000.00	.....	.....	9,450,000.00
Mortgage Bonds.....	98,214,000.00	40,766,752.00	20,227,160.20	118,753,591.80
Collateral Trust Bonds.....	24,295,000.00	.....	.....	24,295,000.00
Debenture Bonds.....	.....	8,500,000.00	.....	8,500,000.00
Bonds and Mortgages on Real Estate.....	797,015.28	66,266.94	20,500.00	842,782.22
Total Funded Debt.....	132,756,015.28	49,333,018.94	20,247,660.20	161,841,374.02
Non-negotiable debt to Affiliated Companies.....	.....	1,146,457.25	817,175.49	329,281.76
<i>Current Liabilities:</i>				
Notes Payable.....	3,300,000.00	.....	500,000.00	2,800,000.00
Traffic and Car Service Balances Payable.....	.....	3,768,709.31	.....	3,768,709.31
Audited Accounts and Wages Payable.....	.....	9,184,109.22	.....	9,184,109.22
Miscellaneous Accounts Payable.....	.....	659,156.85	46,883.02	612,273.83
Interest Matured Unpaid.....	1,931,500.00	9,800.00	.....	1,941,300.00
Funded Debt Matured and Unpaid.....	.....	24,500.00	.....	24,500.00
Unmatured Interest and Rentals.....	475,856.06	560,591.32	.....	1,036,447.38
Other Current Liabilities.....	409,918.97	3,111,396.27	.....	3,521,315.24
Income Received in Advance of Accrual.....	.....	.....	.....	.....
Total Current Liabilities.....	6,117,275.03	17,318,262.97	546,883.02	22,888,654.98
Philadelphia & Reading Coal and Iron Co. Special A/c	2,000,000.00	.....	2,000,000.00	.....
Sinking Fund General Mortgage Loan.....	494.89	.....	.....	494.89
Contingent Account.....	5,152,743.31	.....	.....	5,152,743.31
<i>Deferred Liabilities:</i>				
U. S. Government.....	.....	36,396,350.17	.....	36,396,350.17
Other Deferred Liabilities.....	.....	81,176.57	.....	81,176.57
Total Deferred Liabilities.....	.....	36,477,526.74	.....	36,477,526.74
<i>Unadjusted Credits:</i>				
Tax Liability.....	372,678.21	1,802,934.34	.....	2,175,612.55
Insurance and Casualty Reserves.....	.....	1,043,462.42	.....	1,043,462.42
Operating Reserves.....	.....	711,608.99	.....	711,608.99
Reserve for Replacement of Equipment.....	9,443,324.50	.....	.....	9,443,324.50
U. S. Government.....	.....	4,932.43	.....	4,932.43
Other Unadjusted Credits.....	193,676.62	8,508,979.12	.....	8,702,655.74
Total Unadjusted Credits.....	10,009,679.33	12,071,917.30	.....	22,081,596.63
<i>Corporate Surplus:</i>				
Additions to Property through Income & Surplus	.....	53,451,156.59	.....	.....
Profit and Loss.....	33,996,983.01	10,276,169.32	.....	.....
Total Corporate Surplus.....	33,996,983.01	63,727,325.91	43,608,830.49	54,115,478.43
TOTAL.....	330,033,190.85	222,556,209.11	109,702,249.20	442,887,150.76

Exhibit H

STATE OF PENNSYLVANIA, }
County of Philadelphia, } ss.:

AGNEW T. DICE, being duly sworn according to law, declares that he is the President of Philadelphia and Reading Railway Company and of Reading Company, and is familiar with the assets of both Corporations and has examined the balance sheets of the Reading Company and the Philadelphia and Reading Railway Company as of December 31, 1920, together with the consolidated balance sheet of the Reading Company as it would have been at that date if the transactions contemplated by the Reading plan had then been fully consummated, which are attached as Exhibit "G" to the Answer of Reading Company to certain intervening petitions in this cause. This affiant believes and therefore avers that the valuation at which it is proposed to carry the properties of Philadelphia and Reading Railway Company upon the books of the Reading Company after the consolidation and merger of the two Corporations shall be accomplished according to the provisions of the Reading plan are correctly set forth in the consolidated balance sheet above referred to, included in Exhibit "G" aforesaid.

AGNEW T. DICE.

Sworn to and subscribed before me }
this 5th day of April A. D. 1921 }

J. V. HARE,

Notary Public.

[SEAL]

Commission Expires March 1, 1923.

Exhibit I

COMPARISON OF WORKING ASSETS AND LIABILITIES

	Reading Co. as of December 31, 1920	Philadelphia & Reading R. R. Co. as of December 31, 1920	Reading after Comple- tion of P.
Current Assets.....	\$ 7,015,993.34	\$19,280,705.17	\$41,179,611.39
Deferred Assets.....	.....	43,136,111.39	43,136,111.39
Unadjusted Debits.....	8,215.02	3,295,066.69	3,303,281.71
Securities Issued or As- sumed .....	.....	2,782,000.00	2,782,000.00
Total Working Assets.	\$ 7,024,208.36	\$68,493,883.25	\$90,401,703.49
Current Liabilities.....	6,117,275.03	\$17,318,262.97	\$22,888,525.94
Deferred Liabilities.....	.....	36,477,526.74	36,477,526.74
Unadjusted Credits, Less Reserve for Replace- ment of Equipment.	566,354.83	12,071,917.30	12,638,272.13
Philadelphia & Reading Coal & Iron Co.— Special Account.....	2,000,000.00	.....	.....
Sinking and Contingent Funds	5,153,238.20	.....	5,153,238.20
Amount Payable to Gen- eral Mortgage Bond- holders .....	.....	.....	(not ex- ceeding) 9,400,000.00
Total Working Liabili- ties	\$13,836,868.06	\$65,867,707.01	\$86,557,764.14
Excess of Assets.....(Def.)	\$6,812,659.70	\$2,626,176.24	\$3,843,939.35

**Order Granting Leave to Intervene and Making Central Union Trust
Company Party Defendant.**

(Filed April 12, 1921.)

AND NOW, this 12th day of April, A. D. 1921, the Court having read and considered certain petitions for leave to intervene in the above entitled cause, which, pursuant to permission granted in open Court March 1st A. D. 1921, have been filed with the Court by—

Seward Prosser *et al.*, Committee for Common Stockholders;

Adrian Iselin *et al.*, Committee for Preferred Stockholders;

New York Central Railroad Company;

Baltimore & Ohio Railroad Company;

William B. Kurtz and Madge Fulton Kurtz;

Continental Insurance Company and Fidelity and
Phoenix Fire Insurance Company of New York;

Penn Mutual Life Insurance Company;

Pennsylvania Company for Insurances on Lives and
Granting Annuities;

Frances T. Ingraham, Robert S. Ingraham, Mabel B.
Ingraham and Marcus L. Taft;

The Girard Avenue Title and Trust Company;

Joseph E. Widener.

And the Court having also read and considered the Answer of the Reading Company and the separate Answer of Joseph E. Widener, it is—

Ordered, Adjudged and Decreed that leave be and is hereby given to—

Seward Prosser *et al.*, Committee for Common Stockholders;

Adrian Iselin *et al.*, Committee for Preferred Stockholders;

New York Central Railroad Company;

Baltimore and Ohio Railroad Company;

William B. Kurtz and Madge Fulton Kurtz;

Continental Insurance Company and Fidelity and
Phoenix Fire Insurance Company of New York;

Penn Mutual Life Insurance Company;

Pennsylvania Company for Insurances on Lives and
Granting Annuities;

Frances T. Ingraham, Robert S. Ingraham, Mabel B.
Ingraham and Marcus L. Taft;

The Girard Avenue Title and Trust Company;

Joseph E. Widener,

to intervene in the above entitled cause as parties defendant, on their own behalf and on behalf of all other stockholders and bondholders of Reading Company having and being possessed of similar rights and interests, on condition, however, that all of the said petitioners appearing in a representative capacity, as Committee or otherwise, shall have no rights, or status, as parties defendant aforesaid, unless and until they shall file with the Court, and shall serve upon the Attorney General of the United States and the Solicitor for the Reading Company—

(1) A certified copy of the agreement or other authority under or by virtue of which such Committee or other Petitioner appearing in a representative capacity was constituted or is acting; and

(2) Certified lists of the names and addresses of all stockholders or bondholders alleged to be represented by such Committee, or such other petitioner or petitioners, and the number and class of shares of stock, and the number of bonds, held by each stockholder or bondholder so represented.

It is further ordered that the above named Petitioners appearing on their own behalf and such of the said Petitioners appearing in a representative capacity as shall comply with the conditions set forth above, who shall become parties defendant as aforesaid, shall forthwith cause formal appearance to be entered for them and each of them by Counsel, duly signed by such Counsel in his or their own handwriting, with the post office address of such counsel therein set forth, upon whom service of any and all papers and pleadings in this cause may hereafter be made.

And it is further ordered that, pursuant to the petition of the United States of America, the Central Union Trust Company, of New York, Trustee under the General Mortgage of Reading Company and The Philadelphia & Reading Coal & Iron Company, be and is hereby made party defendant in this cause, with leave to appear by Counsel as aforesaid.

By the Court:

J. W. THOMPSON,
J.

Order Setting Down Questions for Argument.

(Filed April 12, 1921.)

AND NOW, this 12th day of April A. D. 1921, leave having been given to certain Petitioners to intervene in the above entitled cause, by an order this day entered;

And the Court having read and duly considered the Petitions of the said Petitioners and the Answers thereto;

And the Court being of opinion that certain matters

therein presented, in relation to the Reading Plan filed in this cause, should be considered further by the Court only after hearing of the parties of record in this cause; it is

Ordered, Adjudged and Decreed that on Monday, the 2nd day of May, A. D. 1921, at 10:30 A. M., the Court will hear argument upon the following questions:

(1) (a) Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

(2) Whether the stock of the Coal Company should be sold free from the lien of the General Mortgage, or whether a sale of Certificates of Interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

(3) Whether the Reading Company should offer a premium of ten per cent. to the General Mortgage bondholders for release of the Coal Company's property from the lien of the mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause.

It is further ordered that all parties of record who desire to be heard orally, by counsel, on the said second day of May, shall file with the Court, on or before the 30th day of April A. D. 1921, ten copies of a printed brief containing in substance the proposed argument for the party or parties desiring to be heard.

By the Court.

J. W. THOMPSON J.

Appearances.

Appearances were filed as follows:

1. Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, by Alfred A. Cook (filed April 20, 1921).

2. Seward Prosser, Mortimer N. Buckner and John H. Mason as a Committee representing holders of common stock of Reading Company, by J. DuPratt White (filed April 22, 1921).

3. Frances T. Ingraham, *et al.*, by George S. Ingraham (filed April 15, 1921).

4. Adrian Iselin, Robert P. Dodson, Edwin G. Merrill and William A. Law as a Committee representing certain holders of First and Second Preferred stock of Reading Company by Cadwalader, Wickersham & Taft (filed April 29, 1921).

5. New York Central Railroad Company, by George S. Lyman (filed April 16, 1921).

6. Baltimore & Ohio Railroad Company, by H. B. Gill and Hugh L. Bond, Jr. (filed April 27, 1921).

7. William B. Kurtz and Madge Fulton Kurtz, by Thomas Reyburn White (filed April 18, 1921).

8. Penn Mutual Life Insurance Company, by George Wharton Pepper (filed April 19, 1921).

9. Girard Avenue Title and Trust Company, by Michael J. Ryan (filed April 18, 1921).

10. Joseph E. Widener, by Ellis A. Ballard (filed April 26, 1921).

Filing of Certificates.

Certificates with respect to securities of Reading Company owned or represented were filed as follows:

1. By Continental Insurance Company and Fidelity-Phenix Fire Insurance Company, certifying that each of said Companies is the holder of 4200 shares of the common stock of Reading Company (filed April 20, 1921).

2. By Madge Fulton Kurtz, certifying that she is the owner of 1000 shares of the second preferred stock of Reading Company and owns neither first preferred nor common stock nor bonds of the Reading Company (filed April 19, 1921).

3. By William B. Kurtz, certifying that he is the owner of 450 shares of first preferred stock, and 8200 shares of second preferred stock, and that he owns neither common stock nor bonds of the Reading Company (April 18, 1921).

4. By Seward Prosser, Mortimer N. Buckner and John H. Mason, certifying that as a Committee they represent 2629 holders of common stock owning 407,728 shares. Of these holders 462 owned under ten shares, 1362 owned under twenty-five shares, 1644 owned under fifty shares, 1931 owned under one hundred shares and

698 owned one hundred shares or over. These stockholders executed powers of attorney to the Prosser Committee authorizing the Committee to appear personally or by counsel to protect the interests of the holders of common stock of the Reading Company in the proposed plan of segregation (filed April 22, 1921).

5. By Adrian Iselin, Robert P. Dodson, Edwin G. Merrill and William A. Law, certifying that as a Committee they represent 654 holders of first preferred stock, owning 127,592 shares, and 437 holders of second preferred stock, owning 98,741 shares, the aggregate holdings of these 1091 stockholders amounting to \$11,316,350 par value. These stockholders executed powers of attorney to the Iselin Committee, authorizing the Committee to appear personally or by counsel to protect the interests of the holders of preferred stock of the Reading Company in the proposed plan of segregation and particularly to endeavor to secure for the preferred stock equality of treatment with the common stock of the Company (filed April 29, 1921).

6. By Joseph E. Widener certifying that he is the owner of 1900 shares common stock of Reading Company and represents 6700 shares of common stock standing in the name of P. A. B. Widener, and 93,300 shares of common stock of the Reading Company standing in the name of the Estate of P. A. B. Widener.

Modifications of Plan.

(Filed May 12, 1921.)

In pursuance of the direction of this Court at the hearing on May 2, 1921, defendant Reading Company respectfully submits for the consideration of the Court the following modifications of the Plan dated February 14, 1921:

Paragraph numbered 4 of the Plan as modified will read as follows:

4. The Reading Company will agree with the Coal Company that, at or before the maturity of the General Mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the General Mortgage and the discharge of the Coal Company from liability on the General Mortgage bonds.

Paragraph numbered 5 of the Plan as modified will read as follows:

5. If the Court so orders, the Reading Company will, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company, including the present right to vote and receive dividends thereon, to a new corporation to be formed with appropriate powers, and will agree to save the new corporation and said stock harmless from the lien of the General Mortgage, and will agree to obtain, at or before the maturity of the General Mortgage, the release of the stock of the Coal Company from the lien of the General Mortgage and the assignment, transfer and delivery of said stock to the new corporation—all in consideration of the payment by the new corporation to the Reading Company of the sum of \$5,600,000 and its agreement to issue its shares to the stockholders of the Reading Company as hereinafter provided.

The new corporation will issue 1,400,000 shares of

stock without par value. Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each share of Reading stock. Provision will be made for the disposition by the Reading Company of any rights to subscribe which may not be availed of by the Reading stockholders within such period as may be fixed by the Court, to the end that the new corporation shall receive the full purchase price of \$5,600,000. It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific-Southern Pacific case, by issuing to Reading stockholders, with or without the intervention of a trustee, as may be provided for in the final decree of the Court, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company.

In addition there will be embodied in the final decree a permanent injunction against the new corporation exercising its voting power on the stock of the Coal Company in such a way as to bring about any new relations between the Coal Company and the Reading Company of the character complained of in the present suit. Any further steps, which may be deemed necessary by the Court, will be taken to the end that an independent board and management to be approved by it will be maintained for the Coal Company, so that the independence of this Company need not await the necessarily gradual process of the distribution of the no par value stock of the new corporation among persons not holders of stock in the Reading Company.

The final decree may provide that if by reason of default on the General Mortgage bonds the Trustee, the Central Union Trust Company, shall exercise the right to vote the stock of Reading Coal Company, it shall so

exercise that right as not to bring about unity of management between said Coal Company and Reading Company; and the final decree may further provide that, in the event the Trustee at any time is obliged to sell the stock or properties of Reading Coal Company, it shall dispose of such stock and properties separately from the properties of Reading Company and to different interests.

Paragraph numbered 7 of the Plan will be omitted.
Paragraph numbered 8 of the Plan will be numbered 7.

READING COMPANY,
By CHARLES HEEBNER,
General Counsel.

WM. CLARKE MASON,
Solicitor.

R. C. LEFFINGWELL,
Counsel.

Approved on behalf of the United States.

ABRAM F. MYERS,
Special Assistant to the
Attorney General.

Stipulation.

IT IS HEREBY STIPULATED by and between the solicitors for the appellants and appellees that the following documents, papers and summaries, taken from the record of this case prior to the decision of the Supreme Court dated April 26, 1920, shall constitute a part of the Record on Appeal and shall be printed as a part of the transcript of record.

Plan of Reorganization of the Philadelphia and Reading Railroad Company and Philadelphia and Reading Coal and Iron Company, dated December 14, 1895 (Old Record, Government Exhibit 4, Introduced in Evidence, Vol. II, p. 13).

As security-holders are doubtless aware, the undersigned Committee has, for over a year past, devoted its time and attention to the affairs of the above-named companies, and, as a result, a decree for the foreclosure of the General Mortgage is expected shortly to be entered.

The Committee feels, therefore, that the time is now opportune to bring about a reorganization of the properties of the Philadelphia and Reading Railroad Company and of the Philadelphia and Reading Coal and Iron Company on the basis which it originally undertook to accomplish, being one which shall attain the following results:

- (a) the protection of the present General Mortgage;
- (b) the reduction of the fixed charges to a limit safely within the net earning capacity of the reorganized properties;
- (c) adequate provision of cash working capital for future requirements;
- (d) the payment of the floating debt, and provision for the existing car trust obligations;
- (e) such control of the reorganized System until the earnings of the properties shall have placed them in a satisfactory financial position, as shall render additionally secure the new General Mortgage.

Having these objects in view, the annexed plan has been prepared, with the co-operation of Messrs. J. P.

Morgan & Co., who have been selected by the Committee to act as Managers to carry out the plan.

FREDERIC P. OLCOTT,	}	Committee.
ADRIAN ISELIN, JR.,		
J. KENNEDY TOD,		
HENRY BUDGE,		
THOMAS DENNY,		
GEORGE H. EARLE, JR.,		
SIDNEY F. TYLER,		
SAMUEL R. SHIPLEY,		
RICHARD Y. COOK,		

PRELIMINARY CONDITIONS OF PARTICIPATION UNDER THE PLAN.

Participation under the plan of reorganization, in any respect whatsoever, by any stockholder or bondholder affected thereby (as specified on p. 7), is dependent on his depositing his holdings with one of the Depositaries, Messrs. J. P. Morgan & Co., 23 Wall Street, New York; Messrs. Drexel & Co., Fifth and Chestnut Streets, Philadelphia, or Messrs. J. S. Morgan & Co., 22 Old Broad Street, London, within such time as may be fixed, and will embrace only securities so deposited. As to Income Bonds and Stock so deposited, participation is further dependent on the payment of assessments, as provided in the plan (see p. 8). All securities for deposit must be in negotiable form.

The assessments on Income Bonds and Stock will be payable at the office of Messrs. J. P. Morgan & Co., Messrs. Drexel & Co. or Messrs. J. S. Morgan & Co., at the option of each depositor, in four equal installments, at least 30 days apart, when and as called for by advertisement in each instance at least twice a week for two weeks in two of the daily papers of general circulation published in the Cities of New York, Philadelphia and

London, respectively. All payments must be receipted for by one of the Depositaries on the reorganization certificates.

Failure to pay assessments when and as payable, will subject the deposited securities and all rights on account of any prior payments, to forfeiture as hereinafter provided.

The holders of receipts of the Central Trust Company of New York for General Mortgage Bonds deposited under the existing bondholders' agreement of May 7, 1894, shall be entitled to the benefits of this plan without the issue of new receipts or certificates, provided, that within the time limited therefor, such existing receipts be produced to one of the Depositaries and stamped as assenting to this plan.

All holders of General Mortgage bonds not already deposited with the Central Trust Company of New York under the existing bondholders' agreement, shall, by delivery thereof to the Depositaries, be deemed to deposit their bonds under said bondholders' agreement, and, for the bonds deposited, will receive certificates of said Trust Company issued under that agreement, duly stamped by one of the Depositaries as assenting to this plan.

The holders of receipts heretofore issued by the Central Trust Company of New York for First, Second and Third Preference Income Bonds, Deferred Income Bonds and Stock, must surrender the same to one of the Depositaries and must obtain new certificates hereunder in exchange therefor, in order to entitle them to the benefit of this plan. Receipts not so exchanged will not be entitled to participation herein.

PLAN OF REORGANIZATION.

THE NEW COMPANY.

Unless the Managers shall decide to proceed without foreclosure or sale, the properties of the existing Reading companies will be sold and successor companies will be organized under the laws of Pennsylvania; and the stocks and securities of these successor companies will be vested in a new company, formed or to be formed under the laws of Pennsylvania or of some other State. The term "New Company," as hereinafter used, is intended to mean either the existing Reading companies or the New Proprietary Company.

Pending their use for reorganization purposes, all bonds deposited hereunder will be delivered by the Depositaries to the Central Trust Company of New York, and all stock will be delivered in like manner to the Mercantile Trust Company, and shall be held by them respectively subject to the order and control of the Committee. All stocks and bonds deposited under the plan are to be kept alive so long as necessary for the purpose of reorganization.

NEW STOCKS AND BONDS.

A.

THE NEW COMPANY is to authorize the following securities:

1. GENERAL MORTGAGE 100-YEAR 4% GOLD BONDS FOR \$114,000,000.

These bonds are to be secured by mortgage and pledge of all properties and securities embraced in the reorganization as carried out, and also all other property which shall be acquired thereafter by use of any of the new bonds.

Of the new General Mortgage bonds, \$44,550,000 are to be reserved so that they can be issued only against existing undisturbed bonds (Table C); the present Improvement Mortgage bonds amounting to \$9,364,000, maturing in 1897, may, however, be extended at not over $4\frac{1}{2}\%$ per annum interest.

\$20,000,000 of the new bonds will be reserved for purposes of future construction, equipment, etc. (available only to an extent not exceeding \$1,500,000 in any one year), thus providing adequate means for extension of business.

The new mortgage will further provide for the issue, if found desirable, of additional bonds secured thereby (not exceeding \$21,000,000) for the following purposes:

\$8,500,000 to meet the Philadelphia and Reading Terminal bonds

\$12,500,000 to meet the Philadelphia and Reading Coal and Iron bonds

in which case these bonds, or the property covered thereby, will be bought under the new mortgage as additional security therefor.

Suitable arrangements will be made for a sinking fund out of the revenues from the Coal and Iron Company, or its successor, to be used to retire new General Mortgage Bonds, but no compulsory redemption of the new bonds can be made prior to their maturity.

The new mortgage will, subject only to the bonds for which reservation is made, be based upon properties or securities of all the lines of railroad owned by the Philadelphia and Reading Co., 327 miles.

Various leasehold lines, 552 miles, more or less.

All the property of the Coal and Iron Company, or the securities thereof, representing nearly 200,000 acres of coal and timber land.

The new mortgage will also have the benefit of equipment valued at about \$10,000,000, but now subject to

about \$7,300,000 of car trust obligations, which are to be acquired under the plan, and also the marine equipment of the Company.

Furthermore, by the redemption of the present Collateral Trust Mortgage, or the acquisition of the bonds secured thereby, and by the payment of other debts, the new General Mortgage will have a first lien upon a majority or more of the capital stock of various companies in the system owning 448 miles of railroad, of which 195 miles are leasehold lines included in the 552 miles above stated. These 448 miles embrace properties which are essential to the system, no part of which is covered by the present General Mortgage. The securities thus to be pledged, earned last year an income of \$585,000, of which \$448,000 was actually received by the Philadelphia and Reading Railroad Company in the way of dividends, the remainder being retained for betterments and working capital.

The new mortgage will thus have the security of a vast amount of valuable property in addition to that afforded by the present General Mortgage.

2. **NON-CUMULATIVE 4% FIRST PREFERRED STOCK** for **\$28,000,000**, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock. The First Preferred Stock will entitle the holders to non-cumulative dividends up to 4 per cent. per annum, payable out of net earnings before any dividends shall be paid on the Second Preferred or the Common Stock.

3. **NON-CUMULATIVE 4% SECOND PREFERRED STOCK** for **\$42,000,000**, which will entitle the holders to non-cumulative dividends up to 4 per cent. per annum, payable out of net earnings before any dividends shall be paid on the Common Stock.

4. **COMMON STOCK** for **\$70,000,000**, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock.

All the stock will be divided into shares of \$50 or \$100 each.

Provision will be made that at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the First Preferred Stock, the New Company may convert the Second Preferred Stock at par, one-half into First Preferred Stock and one-half into Common Stock.

B.

As a consideration for the property and securities to be conveyed or delivered to the New Company, or which, pursuant to this plan, the New Company shall acquire, it is contemplated that the New Company shall deliver the foregoing bonds and stock, excepting the portions to be held against such of the existing securities as are not disturbed, and such final amounts as shall be reserved for the future use of the New Company.

The requisite deliveries of the new securities to depositors and subscribers under the plan will thus be provided for.

C.

As additional protection to the new General Mortgage bonds, all classes of stock of the new company (except such number of shares as may be disposed of to qualify directors) are to be vested in the following Voting Trustees: J. Pierpont Morgan, Frederic P. Olcott and a third Trustee to be selected hereafter.

In the event of the death of any person designated as a Voting Trustee, prior to the creation of the Voting Trust, the vacancy shall be filled as provided in the Reorganization Agreement. The stock shall be held by the Voting Trustees and their successors, jointly (under a trust agreement prescribing their powers and duties and the method of filling vacancies), for five years, and for

such further period (if any) as shall elapse before the first preferred stock shall have received 4 per cent. cash dividend per annum for two consecutive years, although the Voting Trustees may, in their discretion, deliver the stock at any earlier date. Until delivery of stock is made by the Voting Trustees, they shall issue certificates of beneficial interest entitling the registered holders to receive, at the time therein provided, stock certificates for the number of shares therein stated, and in the meanwhile to receive payments equal to the dividends collected by the Voting Trustees upon the number of shares therein stated, which shares, however, with the voting power thereon, shall be vested in the Voting Trustees until the stock shall become deliverable, as provided in such certificates of the Voting Trustees.

Provision is to be made that no additional mortgage shall be put upon the property to be acquired hereunder, nor the amount of the First Preferred Stock authorized under this Plan be increased, except with the consent, in each instance, of the holders of a majority of the whole amount of each class of Preferred Stock, given at a meeting of the Stockholders called for that purpose, and with the consent of the holders of a majority of such part of the Common Stock as shall be represented at such meeting, the holders of each class of stock voting separately; also that the amount of the Second Preferred Stock shall not be increased except with like consent by the holders of a majority thereof, and a majority of such part of the Common Stock as shall be represented at the meeting. During the existence of the voting trust, the consent of holders of like amounts of the respective classes of beneficial certificates shall also be necessary for the purposes indicated.

The New Company may reserve the right to redeem at any time either or both classes of its Preferred Stock at par in cash, if allowed by law.

D.

THESE NEW BONDS AND STOCK TRUST CERTIFICATES are intended to be used as shown in the accompanying Tables (subject only to such changes as may be necessary for the effective carrying out of the plan), viz.:

BONDS.

For Undisturbed bonds (see Table C) ..	\$44,550,000 00
“ Present General Mortgage bonds (exclusive of about \$1,900,000 pledged as collateral	44,575,000 00
“ Delivery to Syndicate	4,000,000 00
“ New construction, additions and betterments, additional equipment, etc., under carefully guarded restrictions, not over \$1,500,000 to be used in any one year. These bonds will be used only in such manner as additionally to secure the new mortgage	20,000,000 00
“ Contingencies (any surplus to go to new Company)	875,000 00
	<hr/>
	<u>\$114,000,000 00</u>

FIRST PREFERRED STOCK.

For First Preference Income bonds.....	\$7,184,000 00
“ Delivery to Syndicate.....	8,000,000 00
“ Reserve for adjustment with various outstanding bondholders, creditors and stockholding interests, Commission to Refunding and Guarantee Syndicates, and Contingencies (the surplus to go to the new Company)	12,816,000 00
	<hr/>
	<u>\$28,000,000 00</u>

SECOND PREFERRED STOCK.

For First, Second and Third Preference	
Income bonds	\$40,286,000 00
“ Contingencies (the surplus to go to the new Company)	1,714,000 00
	<hr/>
	\$42,000,000 00
	<hr/>

COMMON STOCK.

For Income bonds and Stock.....	\$69,598,000 00
“ Contingencies (the surplus to go to the new Company).....	402,000 00
	<hr/>
	\$70,000,000 00
	<hr/>

The undisturbed bond issues of the Reading system cannot be compulsorily retired prior to their maturity; therefore, reservation of New General Mortgage bonds is made to provide for them as shown above. The security for the present General Mortgage bonds is ample, but a reorganization has become necessary through the creation of debts which have proved a drain upon the resources of the Company and have necessitated a diversion of its income.

DISTURBED SECURITIES AND BASIS OF EXCHANGE.

The securities disturbed in this reorganization are:

General Mortgage 4% Bonds.....	\$44,602,188
1st Preference Incomes.....	23,949,735
2nd Preference Incomes.....	16,176,072
3rd Preference Incomes.....	16,634,462
Capital Stock	41,373,662
Deferred Incomes	20,751,590

The basis of their exchange is as follows:

	RECEIVE:				
	Cash.	New General Mortgage Bonds.	First Preferred Stock Trust Certificates.	Second Preferred Stock Trust Certificates.	Common Stock Trust Certificates.
General Mortgage Bonds ("stamped" receipts heretofore issued by Central Trust Company when "assented"†).	2%*	100%			
General Mortgage Bonds ("unstamped" receipts heretofore issued by Central Trust Company when "assented"†).	12%†	100%			
General Mortgage Bonds heretofore undeposited (when deposited in exchange for assented receipts of Central Trust Company)	12%†	100%			
First Preference Income Bonds¶.....	On payment of assentment as stated on page 2	.....	30%	100%	
Second Preference Income Bonds¶....		.....	.....	65%	55%
Third Preference Income Bonds¶.....		.....	.....	35%	85%
Stock¶.....		.....	.....	.....	100%
Deferred Income Bonds¶.....		.....	.....	.....	20%

*For January, 1896, coupon, payable on or before completion of the reorganization, with interest from January 1, 1896.

The equitable interest certificates hereto issued will be paid in cash at 105 per cent. and interest, on or before completion of the reorganization.

†The 12 per cent. in cash represents coupons from July 1, 1893, to January 1, 1896, and is payable on or before completion of the reorganization, but bears interest at six per cent. per annum from the dates of maturity of the respective coupons until paid. By means of this payment the "unstamped" certificates and heretofore undeposited bonds are placed upon the same footing as the "stamped" certificates.

‡In order to "assent" holders of these receipts must present them for "stamping" as indicated on page 2 of plan.

§All existing receipts for these securities must be exchanged as indicated on page 2 of plan.

The foregoing percentages are based upon the principal amount of the bonds. Undeposited bonds must be deposited with all unpaid coupons.

These new bonds will be for \$1,000 each. Interest will start from January 1st, 1896 (first coupon to mature July 1st, 1896), and will be at four per cent. per

annum. Equitable cash settlement will be made for fractional amounts of new bonds and stock accruing to depositors.

THE ASSESSMENTS on the First, Second and Third Preference Income Bonds on the stock and on the Deferred Income Bonds are:

20 per cent. on First, Second and Third Preference Incomes.

20 per cent. on Stock.

4 per cent. on Deferred Incomes.

A SYNDICATE has been formed by Messrs. J. P. Morgan & Co., J. Kennedy Tod & Co., Hallgarten & Co., and A. Iselin & Co., which definitely agrees:

1. To underwrite the payment of the assessments on the Income bonds and Stock of the present Railroad Company, the Syndicate to acquire all the rights of holders of Income bonds and Stock who shall not deposit their stock and pay the assessments thereon.
2. To take \$4,000,000 of the new General Mortgage bonds and \$8,000,000 of the new First preferred stock.
3. To guarantee the extension or payment of the Improvement Mortgage bonds and of the Coal and Iron Company bonds, most of which will mature within the next two years.

The financial requirements, not only of the reorganization, but of the New Company, as stated above, are thus fully provided for.

The compensation to Messrs. J. P. Morgan & Co. for their services as Managers of the plan and to their above-named associates in the formation of the Syndi-

cate, has been fixed at \$650,000 in addition to all expenses incurred.

CASH REQUIREMENTS AND PROVISION THEREFOR.

The estimated requirements of the plan (including General Mortgage interest up to January 1, 1896) are as follows:

Floating Debt	\$3,800,000 00	
Receivers' Certificates.	3,800,000 00	
Car Trust and Equip- ment Notes	7,300,000 00	
Equitable Interest Cer- tificates and Accrued Interest on un- stamped General Mortgage Trust Cer- tificates and non-de- posited General Mort- gage Bonds about...	6,250,000 00	
Arrearages of Sinking Fund, Divisional Coal Mortgages ...	2,000,000 00	
Reorganization and other expenses, in- cluding commissions to Bankers, unfore- seen items, etc. (any surplus to go to new Company)	2,000,000 00	
		\$25,150,000 00
The assessments will yield	\$20,862,289 00	
The Syndicate will con- tribute in cash.....	7,300,000 00	
		28,162,289 00
Leaving an estimated cash balance of about		\$3,000,000 00

to be used for the purposes of the new Company.

POSITION OF NEW COMPANY.

The annual fixed charges of the reorganized system (see Appendix, Table B) will be about \$9,300,000. An almost immediate reduction of nearly \$500,000 per annum in these fixed charges will, however, be effected through the refunding or extension by the syndicate at 4 to 4½ per cent. of some \$20,000,000 6 per cent. and 7 per cent. bonds shortly to mature, and the extension already effected by the Receivers, at 4 per cent., of \$1,500,000 North Pennsylvania bonds which now bear 7 per cent.

The net earnings of the system for the past four years, terminating November 30th, were:

1892	\$12,472,190 61
1893	11,172,690 56
1894	9,839,971 32
1895 (estimated as to November).....	9,624,123 00

Except for the annual interest charge of about \$105,000, which is now being created through the construction, in connection with the City of Philadelphia, of the Pennsylvania Avenue subway in that city, and the further interest obligations which may gradually arise through the yearly issuance of not exceeding \$1,500,000 of new General Mortgage 4% Bonds for new construction, betterments, etc. (as hereafter required to develop the business), no reason is believed to exist for any increase in the fixed charges of the Reorganized Company.

The New Company will start without floating debt and will be relieved from the embarrassment of Car Trusts which during the last five years have absorbed upwards of \$4,500,000 from its net income, which otherwise might have been free to conserve the property. These Car Trusts, unless provided for, as a part of a comprehensive plan of reorganization, will further absorb over \$7,300,000 additional in the next five years. The new fixed charges will be well within the net income of the system even in the past years of extreme depression, and the New Company will start not only with a substantial working cash capital, but also with power to provide facilities for the increase of business.

APPENDIX.

TABLE A.

PRESENT ANNUAL FIXED CHARGES.

The present fixed charges of both Companies aggregate \$10,035,073, made up as follows:

Interest on Prior Liens including interest on Bonds and Mortgages on Real Estate.....	\$2,666,509
Interest on General Mortgage Bonds.....	1,788,607
Interest on Terminal Loan.....	425,000
Rentals (about).....	2,876,040
Interest Coal & Iron Co.....	1,051,017
Taxes	350,000
	<hr/>
	\$9,157,173
Interest on floating debt and Receivers' certificates...	441,940
Interest on Car Trusts and Equipment Notes.....	435,960
	<hr/>
<i>Total present Fixed Charges.....</i>	<i>\$10,035,073</i>

TABLE B.

ANNUAL FIXED CHARGES AFTER REORGANIZATION.

	Capital	Interest
Prior Mortgage Loans.....	\$5,241,700	\$286,357
Cons. Mortgage Loan, 1871-1911.....	18,811,000	1,235,150
Improvement Mortgage Loan.....	9,364,000	561,840
Cons. Mortgage Loan, 1882-1922.....	5,768,577	288,375
General Mortgage Loan.....	44,715,188	1,788,607
“ “ “ \$4,000,000, new..	4,000,000	160,000
Terminal R. R. Loan.....	8,500,000	425,000
Collateral Sinking Fund Loan.....	1,831,000	91,550
Bonds and Mortgages on Real Estate.....	3,532,896	203,237
Taxes		350,000
Rentals (about).....		2,876,040
Coal and Iron Co. Divisional and Real Estate Mortgages.....	12,383,608	743,017
Coal and Iron Co. Coal Trust Certificates..	4,300,000	258,000
Coal and Iron Co. Commission of Finance Co. of Pennsylvania.....		50,000
	<hr/>	
<i>Total new Fixed Charges.....</i>		<i>\$9,317,173</i>
	<hr/>	
<i>DECREASE IN ANNUAL FIXED CHARGE.....</i>		<i>\$717,900</i>

Application to List on New York Stock Exchange (Old Record, Government Exhibit 4, printed, Vol. II, pp. 306-316).

READING COMPANY,

READING TERMINAL, TWELFTH AND MARKET STREETS,
PHILADELPHIA, March 24, 1897.

TO THE COMMITTEE ON STOCK LIST

NEW YORK STOCK EXCHANGE:

The railroads, property and corporate franchises of The Philadelphia and Reading Railroad Company, and the coal lands and property of The Philadelphia and Reading Coal and Iron Company, included under the General Mortgage made by said two companies under date of January 3, 1888, were sold by the Trustees of that mortgage by virtue of their powers and of the decree of the Circuit Court of the United States, on the 23d day of September, 1896, to Charles Henry Coster and Francis Lynde Stetson.

On the same day all the other assets and property of the Railroad Company and the Coal and Iron Company were sold under the same decree by the Receivers to the same purchasers.

These sales were duly confirmed by the Court, and conveyances and transfers of all the property were duly made and delivered, vesting in the purchasers an absolute title, free and discharged of all the liens and charges, except the prior mortgages and charges and expenses particularly mentioned in said decree.

ORGANIZATION.

A large part of the property so purchased was conveyed by the Purchasers to the Reading Company. All of the remainder (with a few unimportant exceptions) was conveyed to the Philadelphia and Reading Railway Company and The Philadelphia and Reading Coal and Iron Company, and the Reading Iron Company.

READING COMPANY.

The Excelsior Enterprise Company was incorporated by an Act of Assembly of the State of Pennsylvania, approved May 24, 1871. On January 18, 1873, in pursuance of power conferred by the charter, the stockholders changed the name to "National Company"; and on December 7, 1896, in like manner, the name was changed to "Reading Company."

The validity of this charter and its sufficiency for the purposes of this reorganization were considered by the following counsel, viz.: Messrs. George F. Baer, J. D. Campbell, Thomas Hart, Jr., Francis Lynde Stetson, Victor Morawetz, John G. Johnson, Samuel Dickson, James Boyd, George L. Rives, F. W. Whitridge, Hon. Edward M. Paxson and Hon. Edward J. Phelps, and a copy of their joint opinion is submitted herewith. Said opinion concludes as follows:

"In our opinion, the READING COMPANY can legally acquire, receive and hold, and can mortgage and pledge, all the stocks, securities and properties, including the capital stocks of the New Railway Company and of the Coal and Iron Company; and it can keep and perform all the covenants and conditions under which, severally and respectively, these two companies acquired their properties from the Purchasers. By a further increase of its capital,* the READING COMPANY can legally issue the Common and Preferred Stock, and the Bonds required by the Plan of Reorganization; and, to secure the payment of these bonds, it can lawfully pledge and mortgage the stock, securities and properties by it so acquired."

The Attorney General of the State of Pennsylvania, having subsequently questioned the validity of the charter and having instructed the State officials not to accept certain franchise-moneys, the facts of the case were laid

* This increase has been duly made.

before him, and his opinion is also submitted. While questioning certain powers which it is not intended to use, he says:

"After due consideration, I reach the conclusion, most reluctantly, that the Commonwealth of Pennsylvania cannot now successfully attack the chartered rights of the READING COMPANY; at least, the rights of such a nature and character as had been exercised by the corporation prior to January 1, 1874. It had power to do the business in which it was engaged prior to the adoption of the new Constitution."

* * * * *

"My view of the whole matter is that the charter of the Company authorized it to do the kind of business in which it engaged prior to January 1, 1874, which business was of the same general character as that in which it proposes to engage for the purpose of controlling the stocks of the Railway Company and the Coal and Iron Company."

THE CAPITAL STOCK OF THE READING COMPANY consists of 2,800,000 shares of \$50 each (\$140,000,000), of which

560,000 shares (\$28,000,000) are first preferred,
non-cumulative 4 per cent.;

840,000 shares (\$42,000,000) are second preferred,
non-cumulative 4 per cent.;

1,400,000 shares (\$70,000,000) are common,

all of which (except the original issue of 1,000 shares for cash), as well as bonds as hereinafter stated, have been issued for property acquired. The recipients of said stock have deposited same (except 2,000 shares of common stock) with Messrs. J. Pierpont Morgan and Frederic P. Olcott, of New York, and Henry N. Paul, of Philadelphia, as Voting Trustees, under an agreement which provides that it shall be held by them until January 1, 1902, and for such further period (if any) as shall elapse before the first preferred stock shall have received 4 per cent. per annum cash dividend for two consecutive years, although the Voting Trustees may, in their discretion, deliver the stock at any earlier date. Until delivery of

stock is made by the Voting Trustees they shall issue certificates of beneficial interest entitling the registered holders to receive, at the time therein provided, stock certificates for the number of shares therein stated, and in the meanwhile to receive payments equal to the dividends collected by the Voting Trustees upon the number of shares therein stated, which shares, however, with the voting power thereon, are vested in the Voting Trustees until the stock shall become deliverable, as provided in such certificates of the Voting Trustees.

The stock certificates provide in substance that no additional mortgage shall be put upon the property acquired under the plan of reorganization, nor shall the amount of the first preferred stock authorized under said plan be increased, except with the consent, in each instance, of the holders of a majority of the whole amount of each class of preferred stock, given at a meeting of the stockholders called for that purpose, and with the consent of the holders of a majority of such part of the common stock as shall be represented at such meeting, the holders of each class of stock voting separately; also that the amount of the second preferred stock shall not be increased except with like consent by the holders of a majority thereof, and a majority of such part of the common stock as shall be represented at the meeting; except that at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two consecutive years on the first preferred stock, the Company may convert the second preferred stock at par, one-half into first preferred stock and one-half into common stock, and may increase said classes of stock by the necessary amounts. During the existence of the voting trust the consent of holders of like amounts of the respective classes of beneficial certificates is also necessary for any increase of stock other than for the purpose indicated.

The Reading Company reserves the right to redeem at any time either or both classes of its Preferred Stock at par in cash, if allowed by law.

The READING COMPANY owns and has pledged for its mortgage hereinafter mentioned:

A.—Railway Equipmen valued at.....	\$16,950,000 00	
Real Estate of Railroad Company (this does not include rights of way, depots, &c., or any real estate appurtenant to the railroads) valued at.....	16,000,000 00	
Colliers and Barges valued at.....	1,450,000 00	
		\$34,400,000 00

The details of the Equipment are as follows:

	Number.	Value.
Railroad Locomotives.	791	\$3,874,339 80
Railroad Cars.....	29,625	13,110,666 39
Marine Boats	118	1,439,850 00
Canal Boats	50	19,700 00
		\$18,444,556 19

(The old mortgages of the Philadelphia and Reading Railroad Company attach to most of this property.)

B.—Stocks and Bonds:

Stock of Philadelphia and Reading Railway Company, at par.....	\$20,000,000 00
Bond of Philadelphia and Reading Railway Company, at par.....	20,000,000 00
Stock of The Philadelphia and Reading Coal and Iron Co. at par.....	8,000,000 00
Stock of The Reading Iron Company, at par	1,000,000 00
Other stocks and bonds (as per schedules annexed) which control about 275 miles of railroad, at par.....	38,488,246 00

87,448,246 00
*266,594 11

C.—Mortgages and Ground Rents, at par.....

D.—Philadelphia and Reading Coal and Iron Co.:

Assets as shown by its books.....	\$95,435,453 79
Less bonds, &c.....	\$17,874,606 46
“ current liabilities.	1,406,168 34
“ stock of P. & R. C. and I. Co. included in “stocks and bonds”.	8,000,000 00
	27,280,774 80

68,154,673 93
3,343,282 53

E.—Claims against other Companies (see schedule annexed)..

F.—Other Stocks and Bonds:

SCHUYLKILL NAVIGATION COMPANY.*	
Preferred and Common Stock.....	\$3,941,800 00
SUSQUEHANNA CANAL CO.*	
Bonds and Stock.....	3,848,160 94

\$7,789,960 94

Valued at 1,000 00
Estimated worth (“A” being subject to undisturbed bonds as stated further on)..... \$193,613,962 00

* These are not under the mortgage of Reading Co. and Coal and Iron Co.

It will be observed that among the principal assets of the Reading Company is its ownership in the securities of the Philadelphia and Reading Railway Company and The Philadelphia and Reading Coal and Iron Company. By means of the former, the practical ownership of the Railway Company is vested in the Reading Company. The mortgage securing the bond of the Railway Company provides for additional bonds up to \$10,000,000, which, together with like amounts of capital stock, may be issued from time to time *to the Reading Company* in order to enable the latter to deposit same under *its* mortgage and obtain the issue of a like amount of the reserved bonds thereunder, when and as the Reading Company advances money for new construction, &c., upon the lines of the Railway Company and of certain of the companies leased or controlled by it. In this way the lien of the Reading Company's mortgage on the property of the Railway Company is constantly preserved and strengthened. The Railway Company's mortgage is stringent in its provisions and allows the issue of the \$10,000,000 bonds only in a manner and for purposes which are consistent with the provisions of the Reading Company mortgage.

PHILADELPHIA AND READING RAILWAY COMPANY.

In pursuance of the Acts of Assembly of the State of Pennsylvania of May 31, 1887, the before-mentioned purchasers of the railroad property organized a new corporation under the name of "PHILADELPHIA AND READING RAILWAY COMPANY;" and conveyed to it certain railroads and properties acquired by them at the foreclosure sale, in consideration, among other things, of the issue of the entire capital stock (\$20,000,000) and of \$20,000,000 bonds secured by mortgage.

It owns Railroad (but no equipment) of an aggregate length of 390.99 miles.

Of which about 180 miles are double-tracked.

It has acquired Leases of.....597.00 miles.

Of which about 186 miles are double-tracked.

It leases from "Reading Company":

Equipment, \$16,950,000 @ 8% (and taxes).....

Colliers and Barges, \$1,450,000 @ 8% (and taxes)....

Delaware River Wharves @ \$50,000 per annum.....

There are undisturbed bonds of the P. & R. R. R. Co. on the property of the Railway Company as follows:

	Principal.	Interest.
Prior Mortgage Loans.....	\$5,241,700 00	\$286,357 00
Consolidated Mortgage Loans.....	18,811,000 00	1,235,150 00
Improvement " " @ 4% ...	9,364,000 00	374,560 00
Consol. Mortgage of 1882, 1st series, @ 4%	5,767,042 00	230,682 00
Consol. Mortgages of 1883, 2d series....	1,535 00	
Terminal Loan, @ 5%.....	8,500,000 00	425,000 00
Bonds and Mortgages on Real Estate..	844,871 35	41,439 00
	<hr/> \$48,530,148 35	<hr/> \$2,593,188 00
The Company is also liable for Subway Bonds of the City of Philadelphia (ultimately to be increased to \$3,000,000, @ 3½%).....	300,000 00	10,460 00

THE PHILADELPHIA AND READING COAL AND IRON COMPANY.

The decree of confirmation and the conveyances above referred to expressly excepted and released the corporate franchises of The Philadelphia and Reading Coal and Iron Company, so that these corporate rights and powers have been preserved to it; and the Purchasers conveyed to that Company the principal part of its former property upon condition and in consideration, among other things, that the Coal and Iron Company should become co-obligor in the bonds to be created and issued by the "Reading Company" under the Plan of Reorganization, and to secure such bonds, should make and execute a mortgage on all its properties and franchises.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY

A.—Owns:	
Coal lands.....	.95,144 acres.
Valued on the books at.....	\$76,294,997 80
B.—Leases:	
Coal Lands	7,429 acres.
C.—Also owns:	
Timber Lands	\$659,965 00
Eastern Depots	710,724 34
Western Depots	657,709 35
Coal on hand, and other Current Assets...	7,414,232 30

9,442,630 99

Stocks of separate coal companies, viz.:

The Preston Coal and Improvement Co.	\$2,834,150 00
The Fulton Coal Company	317,685 00
The Locust Gap Improvement Co.	525,220 00
The Tremont Coal Company	2,958,850 00
The Mammoth Vein Coal and Iron Company....	604,270 00
The Delaware Coal Company	261,650 00

Nearly all of these Stocks are subject to the Consolidated Mortgage of 1871-1911.

All are covered by new mortgage. See Schedule A.

7,501,825 00

Bonds of separate coal companies:

Preston Coal and Improvement, 7% Mortgage Bonds.....	\$1,087,000
Tremont Coal Co., 6% Mortgage Bonds	900,000
Mammoth Vein Coal and Iron Co., 8% Mortgage Bonds....	209,000

(These are Collateral for Sinking Fund Loan of \$1,774,000; also covered by new mortgage. See Schedule A)

2,196,000 00

\$95,435,453 79

D.—It owes for Bonds matured and maturing. \$12,050,606 46

{ For which bonds of the New General Mortgage are to be substituted.

E.—It assumes Coll. Sinking Fund Loan of 1892 of R. R. Co..... 1,774,000 00

F.—It owes Coal Trust Certificates (\$4,300,000 —\$250,000) 4,050,000 00

G.—Current Liabilities 1,406,168 34

\$19,280,774 80

EARNINGS AND FIXED CHARGES.

Stated in detail, on completion of reorganization the results of the three companies will show as follows:

READING COMPANY.

ESTIMATE OF FIXED CHARGES OF READING COMPANY:

Railroad Company mortgages on real estate	\$2,276,491 65	\$110,000 00
New Bonds.....	50,369,054 00	2,014,762 00
		<hr/>
		\$2,124,762 00
Taxes, &c., say		200,000 00
		<hr/>
		\$2,324,762 00

ESTIMATE OF INCOME OF READING COMPANY (BASED ON 1896 RESULTS):

From Railway Company for rental of equipment, colliers, etc.	\$1,472,000 00	
From Railway Company for rental of Delaware wharves	50,000 00	
From Railway Company interest (\$20,000,000)	1,200,000 00	
“ securities	781,023 00	
“ real estate (formerly of railroad company)	125,000 00	
	<hr/>	3,628,023 00
Surplus		\$1,303,261 00

RAILWAY COMPANY.

Interest on undisturbed bonds, etc.....	\$2,603,648 00
“ “ \$20,000,000 bond held by Reading Company.....	1,200,000 00
Rentals (railroads), say	3,100,000 00
“ (equipment, colliers and wharves) as above, say.....	1,522,000 00
Taxes	175,000 00
Sundries	75,000 00
	<hr/>
Total fixed charges of Railway Company, say.....	\$8,675,648 00
Property now controlled by Railway Company, earned, net, in year ending November 30, 1896.....	8,805,807 00
	<hr/>
Surplus	\$130,159 00

COAL AND IRON CO.

Interest on

\$12,050,000 New General Mortgage 4s to replace Outstanding Div. Coal Land Bonds and Mortgages	\$482,000
Coal Trust Certificates, \$4,050,000, @ 6%....	243,000
Coal Trust Commission	50,000
	<hr/>
	\$775,000 00

Interest on Collateral Sinking Fund Loan, \$1,774,000, @ 5%

88,700 00

Total	\$863,700 00
Net earnings, year ending November 30, 1896.....	238,344 00

Deficit

\$625,356 00

EARNINGS OF ALL COMPANIES IN YEAR ENDING NOVEMBER 30, 1896.
(After paying all Fixed Charges as they will stand on Completion of Plan.)

	DEFICIT.	SURPLUS.
Railway Company		\$130,159 00
Coal and Iron Company.....	\$625,356 00	
Reading Company		1,303,261 00
Surplus, all Companies (to balance).....	808,064 00	
	<u>\$1,433,420 00</u>	<u>\$1,433,420 00</u>

Stated in the simpler form, which was adopted in the plan of reorganization, and eliminating all accounts between the three companies:

NET EARNINGS

of entire property (including income from all sources) in year ending November 30, 1896, were \$9,480,736

FIXED CHARGES

of entire property on completion of reorganization will be..... \$8,672,672

For the present year, pending completion of refunding schemes, etc., they will be, perhaps, \$300,000 @ \$400,000 more.

Referring to the Plan of Reorganization, dated December 14, 1895, it will be noticed on page 10 thereof, that the fixed charges after reorganization, are stated at about.....	\$9,300,000
Add for subway so far accrued.....	10,460
	<u>\$9,310,460</u>
The plan further states that by refunding of high-rate bonds, &c., these charges will be reduced by about.....	500,000
Making	<u>\$8,810,460</u>

the ultimate fixed charge under the plan. Under the plan as actually carried out, they will not be over \$8,672,672.

The accounts of all the Companies, as reorganized, have started from November 1, 1896. Eliminating all accounts between the three companies; the results since then are substantially the same as for the corresponding period of last year.

MORTGAGE.

Under date of January 5, 1897, the Reading Company and The Philadelphia and Reading Coal and Iron Company executed a joint mortgage to the Central Trust Company of New York,

The mortgage contains stringent provisions regulating the use of the new bonds, of the same general character as those in the Southern Railway Company, Erie Railroad Company and Northern Pacific Railway Company mortgages—with such changes, of course, as are necessary for the requirements of this particular case.

Excepting the mortgages and ground rents, of an aggregate value of \$266,594.16, and the Canal securities, valued at \$1,000, the mortgage covers all the property, including stocks and bonds (excepting such few shares of stock as qualify directors, etc.), owned by the Reading Company, as hereinbefore described, and all the property of the Coal and Iron Company; also, all property hereafter acquired by use of the \$20,000,000 reserved bonds.

For a better understanding of the matter it may be stated, in general terms, that, either by way of direct mortgage or collateral trust, the new mortgage has the security of substantially all of the property formerly of The Philadelphia and Reading Railroad Company, and of The Philadelphia and Reading Coal and Iron Company, as acquired under the Court's decree above mentioned, subject to \$64,630,946 of outstanding bonds, which constitute prior liens on parts thereof, and of which \$12,050,606 are now being paid off, so that the prior liens will shortly be reduced to about \$52,500,000. In addition to thus reducing the prior liens, the new mortgage also covers a vast amount of property of large present earning capacity, which was not included in the former General Mortgage, as for instance the stocks and bonds which were under the former Collateral Trust (now paid off), and which yield a present annual income of fully \$500,000. Also Equipment costing about \$10,000,000, most of which was formerly under Car Trusts, etc.

The bonds issued and to be issued under said mortgage are payable, principal and interest, at the office or agency of the Reading Company in the City of New York, in gold coin of the United States of the present standard

of weight and fineness, without deduction for any tax or taxes of the United States or any State or Municipality thereof which the Companies, or either of them, may be required to pay or to retain therefrom under any present or future law. The principal is due January 1, 1997, and the interest July first and January first in each year, at four per cent. per annum. The bonds are in coupon form of \$1,000 each, with right of registration of principal and with right of conversion into registered bonds of \$500, \$1,000, \$5,000 and \$10,000. Such registry and conversion may be made at the office of Messrs. J. P. Morgan & Co., in New York.

The mortgage provides that

the Reading Company shall not and will not in any year declare or pay dividends upon its stock, either common or preferred * * * unless prior to, or simultaneously with, such declaration, it shall deliver to the Trustee a statement in writing under its corporate seal, showing the amount of anthracite coal mined, from lands owned by the Coal Company and mortgaged hereunder during the year next preceding the declaration of such dividend, and simultaneously shall pay to the Trustee a sum equal to five cents per ton on all coal so mined in the preceding year, if the aggregate of dividends so declared shall be equal to or shall exceed such sum, and otherwise such lesser sum as shall be equal to the aggregate of dividends so declared.

All sums so received by the Trustee shall * * * be applied in purchasing bonds secured by the mortgage in such manner as to it shall seem best and at such prices as it shall deem best, but not exceeding par and accrued interest * * * or with the approval of the Reading Company at higher prices than those above fixed; or such unapplied balance shall be invested in securities in which Savings Banks at such time shall be authorized under the laws of New York to invest their funds, such securities to be held by the Trustee as a part of the trust estate * * *

All bonds secured by the mortgage, when so purchased by the Trustee, shall be canceled.

There are submitted herewith :

Copy of mortgage, with usual certificates.

“ “ stock certificates.

“ “ voting trust agreement.

Schedule of stocks and bonds owned.

“ “ equipment.

“ “ claims against other Companies.

Balance Sheets of the three Companies December 1, 1896.

Opinion of 12 counsel as to Reading Company's charter and powers.

Opinion of Attorney General of Pennsylvania as to same.

Opinion of counsel as to new stocks and bonds.

Engineers' certificate.

Specimens of Bonds, Stock Trust Certificates and Discharge Warrants.

Application is hereby made for the listing of \$62,419,000 bonds of the Reading Company and of the Philadelphia and Reading Coal and Iron Company, being coupon bonds Nos. 1 to 62,419, inclusive, of \$1,000 each, issued under their joint mortgage of January 5, 1897, and of the registered bonds into which same may be converted.

The bonds for which a quotation is now desired are those issuable at once, as stated above—viz. \$50,369,000—and those which are now being used for the retirement and cancellation of the Coal and Iron Company bonds generally known as Divisional Bonds—viz., \$12,050,606.

Of the \$50,369,000 bonds, about \$45,000,000 represent the old General Mortgage bonds deposited under the plan, and the remainder are sold for cash or used for other purposes of the reorganization pursuant to the plan.

EXCHANGE OF SECURITIES.

The basis of exchange of the old securities for new securities, pursuant to the before-mentioned plan of reorganization, is as follows:

OLD SECURITIES.	RECEIVE :			
	New General Mortgage Bonds	First Preferred Stock Trust Certificates	Second Preferred Stock Trust Certificates	Common Stock Trust Certificates
General Mortgage Bonds (in addition to all back interest in cash.....)	100%			
First Preference Income Bonds..... (20% assessment paid).	30%	100%	
Second Preference Income Bonds..... (20% assessment paid).	65%	55%
Third Preference Income Bonds..... (20% assessment paid).	35%	85%
Stock..... (20% assessment paid).	100%
Deferred Income Bonds..... (4% assessment paid).	20%

OFFICERS AND DIRECTORS.

The Directors of the Reading Company are as follows: Joseph S. Harris, A. J. Antelo, Thomas McKean, Chas. H. Coster, Francis Lynde Stetson, Geo. F. Baer, John Lowber Welsh, Albert Foster, George C. Thomas. Officers: President, Joseph S. Harris; Vice-President, W. R. Taylor; Treasurer, W. A. Church; Secretary, W. G. Brown.

The Directors of The Philadelphia and Reading Coal and Iron Company are as follows: C. Tower, Jr., Chas. H. Coster, Thomas McKean, John Lowber Welsh, George F. Baer, George C. Thomas. Officers: President, Joseph S. Harris; Vice-President, W. R. Taylor; Treasurer, W. A. Church; Secretary, F. P. Kaercher; Assistant Secretaries, H. C. Russell and W. G. Brown; General Manager, C. E. Henderson; General Coal Agent, Thos. M. Richards; General Superintendent, R. C. Luther.

The Directors of the Philadelphia and Reading Railway Company are as follows: Chas. H. Coster, Francis Lynde Stetson, John Lowber Welsh, George F. Baer, George C. Thomas, Thomas McKean. Officers: President, Joseph S. Harris; First Vice-President, Theodore Voorhees; Second Vice-President, C. E. Henderson; Treasurer, W. A. Church; Secretary, W. R. Taylor.

READING COMPANY,

By

JOS. S. HARRIS, President.

THE PHILADELPHIA AND READING COAL
AND IRON COMPANY,

By

JOS. S. HARRIS, President.

NEW YORK, March 24, 1897.

Referring to the foregoing application of the Reading Company and The Philadelphia and Reading Coal and Iron Company, application is further made for the listing of Voting Trustees' Certificates, as therein described, representing:

560,000 shares (par \$50) first preferred, non-cumulative, 4 per cent. stock.....	} of the Reading Company.
840,000 shares (par \$50) second preferred, non-cumulative, 4 per cent. stock.....	
1,398,000 shares (par \$50) common stock.....	

These certificates are issued and transferred in New York by J. P. Morgan & Co., as agents for the Voting Trustees, and are registered there by the Central Trust Company as registrar of transfers. They are also issued and transferred in Philadelphia by Drexel & Co. as such agents, and registered there by The Pennsylvania Company for Insurances on Lives and Granting Annuities as such registrars. Certificates issued in either place may be discharged to the other at the office of the agents for the Voting Trustees.

J. P. MORGAN & Co.,
Agents for Voting Trustees.

PHILADELPHIA AND READING RAILWAY COMPANY.

BALANCE SHEET, DECEMBER 1, 1896.

RAILROAD	\$80,029,849 19
Pennsylvania Terminal.....	8,500,000 00
Philadelphia Subway.....	300,000 00
CURRENT BUSINESS ASSETS:	
Cash.....	\$1,061,291 08
Materials on hand.....	942,778 81
	<hr/>
	2,004,069 89

MORTGAGE DEBTS ON PROPERTY:	
Five Per Cent Mortgage Loan, 1843-1910, Coupon.....	\$967,200 00
" "	545,500 00
" "	795,000 00
" "	92,000 00
" "	67,000 00
" "	1,000 00
" "	78,000 00
" "	2,696,000 00
	<hr/>
Consolidated Mortgage Loan, 1871-1911—	
6% gold \$ or £ coupon.....	\$6,999,000 00
6% " " " registered.....	305,000 00
6% "	858,000 00
7% "	3,339,000 00
7% "	7,310,000 00
	<hr/>
Improvement Mortgage Loan, 1873-1897—	
6% gold \$ or £ coupon.....	First Series—
Five Per Cent Consols Mtge. Loan, 1882-1922, First Series—	\$5,766,500 00
5% gold \$ coupon.....	542 00
5% " " " fractional scrip.....	
	<hr/>
Five Per Cent Consols Mtge. Loan, 1882-1922, Second Series—	
5% gold \$ coupon.....	\$1,000 00
5% " " " fractional scrip.....	535 00
	<hr/>
Bonds and Mortgages on Real Estate.....	1,535 00
Philadelphia and Reading Terminal R. R. Loan, 1891-1941—	844,572 19
5% gold \$ coupon.....	
Six Per Cent Mortgage Loan, 1896-1997, gold \$ registered...	\$500,000 00
	*20,000,000 00
	<hr/>
Total Mortgage Loans.	\$68,529,849 19
	<hr/>
CITY OF PHILADELPHIA SUBWAY LOAN, GUARANTEED—	
3% due December 31, 1904.....	\$8,000 00
3 1/2% due December 31, 1904.....	142,000 00
3 1/2% due December 31, 1905.....	150,000 00
	<hr/>
CAPITAL STOCK.....	300,000 00
CONTINGENT ACCOUNT (to be adjusted on completion of reorganization)	*20,000,000 00
	<hr/>
	\$80,029,849 89

THE PHILADELPHIA AND READING COAL AND IRON COMPANY.
GENERAL BALANCE SHEET, DECEMBER 1, 1896.

CAPITAL ACCOUNTS.		AMOUNT	TOTAL	CAPITAL ACCOUNTS.		AMOUNT.	TOTAL.
<p>Coal Lands..... Timber Lands..... New York and Eastern Depots..... Western Yards and Depots..... Miners' and other Houses..... Pottsville Shops, Real Estate and Improvements..... Other Real Estate..... Improvements at Collieries on Company's Lands..... Improvements at Collieries on Leased Lands..... Equipments at Collieries..... Deadwork at Collieries..... Storage Yards and Washeries..... Stocks of Companies controlled..... Bonds of Companies controlled.....</p>		<p>\$61,773,116 90 693,965 00 710,734 34 637,719 35 545,967 67 366,640 74 84,759 83 4,797,019 79 2,261,670 53 2,302,467 63 3,711,477 31 439,898 40 7,501,823 00 2,196,000 00</p>		<p>Divisional Coal Land Mortgage Bonds: 1872-1897..... 1872-1902..... 1873-1898..... 1874-1884..... 1874-1899..... 1876-1890..... 1882-1902..... 1883-1898..... 1884-1904..... 1892-1897..... 1893-1908.....</p>		<p>\$8,640,000 00 150,000 00 284,000 00 304,000 00 1,240,000 00 150,000 00 162,000 00 110,000 00 160,000 00 327,000 00 30,000 00 24,500 00</p>	
<p>ASSETS.</p> <p>Cash on hand..... Bills Receivable..... Coal and Rent Accounts..... Sundry Accounts..... Coal on hand..... Endowment Fund, Miners' Beneficial Association..... Supplies and Materials on hand.....</p>		<p>\$334,304 98 224,001 45 2,877,273 27 286,073 74 3,124,958 82 \$30,000 00 457,630 04</p>	<p>\$88,021,221 40</p>	<p>Bonds and Mortgages on Real Estate..... Albright Mortgage, 1902..... Debenture Bonds..... P. & R. Co., Collateral Sinking Fund Loan..... Capital Stock..... Reading Company.....</p>		<p>\$277,108 46 290,000 00 1,774,000 00 8,000,000 00 66,164,678 90</p>	<p>\$11,477,500 00</p>
<p>LIABILITIES.</p> <p>Coal Trust, five-year Gold Loan..... Receivers' Vouchers..... Lehigh & Wilkes Barre Coal Co..... Current Business Debt..... Western Freight, Tolls, &c..... Royalties..... Due for Coal Purchased..... Wages and Material Bills..... Interest Due and Uncollected.....</p>		<p>.....</p>	<p>6,936,612 26 477,690 04</p>	<p>.....</p>		<p>..... \$51,308 57 133,968 52 91,974 96 301,775 41 707,189 59 84,119 50</p>	<p>4,050,000 00 36,752 09 57,186 68</p>
			\$95,435,453 79				\$95,435,453 79

READING REORGANIZATION.

Opinion of Counsel (Old Record, Government Exhibit 4, Introduced
in Evidence, Vol. II, p. 13).

7TH DECEMBER, 1896.

Messrs. J. P. MORGAN & Co.,

Reorganization Managers:

DEAR SIRS—We have carefully considered the Plan and Agreement of Reorganization of the Philadelphia and Reading Railroad Company and of The Philadelphia and Reading Coal and Iron Company, dated December 14, 1895.

This Plan contemplated the foreclosure sale of the properties of the two Reading companies and the organization of successor companies under the laws of Pennsylvania, and the vesting of the stocks and securities of these successor companies in a "New Company" formed or to be formed under the laws of Pennsylvania or of some other State. The Agreement authorized the Managers to adopt or use any existing or future companies for carrying out the provisions of the Plan.

Proceeding in execution of this Plan and Agreement, and in pursuance of the powers thereby conferred, the foreclosure sale has been had, two successor companies have been created or restored, and severally have been invested with properties of the old Reading Companies; and it is now proposed to establish the New Proprietary Company contemplated by the Plan, and to transfer to it the stocks and securities of the Philadelphia and Reading Railway Company and The Philadelphia and Reading Coal and Iron Company, together with other properties formerly of the two old companies, and then to cause

this New Company to issue new securities as contemplated by the Plan and Agreement of December 14, 1895.

Our opinion is asked as to whether you may now properly adopt the "READING COMPANY," formerly NATIONAL COMPANY, to be the New Company to carry out the Plan and Agreement, and we answer that in our opinion you can now properly adopt this Company, our opinion being founded on the following considerations:

THE FORECLOSURE AND THE PURCHASERS.

The railroads and property and corporate franchises of the Philadelphia and Reading Railroad Company, and the coal lands and the property of the Philadelphia and Reading Coal and Iron Company, included under the General Mortgage of 1888, were sold by the Trustee in that Mortgage by virtue of the powers conferred by the Mortgage and of the decree of the Circuit Court of the United States, on the 23d day of September, 1896, to Charles Henry Coster and Francis Lynde Stetson.

On the same day all the other assets and property of the Railroad Company and the Coal and Iron Company were sold under the same decree by the Receivers to the same purchasers.

These sales were duly confirmed by the Court, and conveyances and transfers of all the property were duly made and delivered, vesting in the purchasers an absolute title, free and discharged of all liens and charges, except the prior mortgages and certain charges and expenses particularly mentioned in said decree.

THE PHILADELPHIA AND READING COAL AND IRON COMPANY.

The decree of confirmation and the conveyances expressly excepted and released the corporate franchises of the Philadelphia and Reading Coal and Iron Company,

so that these corporate rights and powers have been preserved to that Company; and the Purchasers have conveyed to that Company the principal part of its former property upon condition and in consideration, among other things, that the Coal and Iron Company shall become co-obligor in the bonds to be created and issued by the "New Company" under the Plan of Reorganization, and to secure such bonds, shall make and execute a mortgage on all its properties and franchises.

PHILADELPHIA AND READING RAILWAY COMPANY.

In pursuance of the Acts of Assembly of the State of Pennsylvania of May 31, 1887, Messrs. Coster and Stetson, as purchasers of the railroad property, have organized a new corporation under the name of "PHILADELPHIA AND READING RAILWAY COMPANY;" and have conveyed to the Railway Company, certain railroads and properties acquired by them at the foreclosure sale, in consideration, among other things, of the issue of the entire capital stock (\$20,000,000) and of \$20,000,000 bonds secured by mortgage, which, under careful limitations, permits the issue of other bonds to an additional amount, not exceeding \$10,000,000, for one-half the cost of property and betterments to be added to the mortgaged premises.

The Philadelphia and Reading Railway Company possesses all the rights, powers, immunities, privileges and franchises which the Philadelphia and Reading Railroad Company possessed at the time of the sale and of the conveyance, except in so far as the same are modified by the Act of 1887 (the only modification in that act being as to the time of the annual meeting), and the Constitution of the Commonwealth of Pennsylvania, which took effect January 1, 1874.

READING COMPANY.

The purchasers have acquired the capital stock of the "NATIONAL COMPANY," and have taken the proper proceedings to change its name to "READING COMPANY."

This Company was incorporated by an Act of Assembly of Pennsylvania, approved May 24, 1871, under the name of "Excelsior Enterprise Company." The capital stock was fixed at \$100,000, divided into two thousand shares of \$50 each, with "the privilege of increasing to such an amount as they from time to time deem needful." The act provided that when one thousand shares should have been subscribed and twenty per centum paid in, the shareholders could elect directors, and that the directors so elected should have and exercise all the rights and privileges conferred by the act.

The record show that the requisite number of shares was duly subscribed, and that the Company was duly organized. On May 25, 1871, the first installment of the "*bonus*" on the capital stock was paid to the Commonwealth.

On January 18, 1873, in pursuance of the powers conferred by the charter, the stockholders changed the name of the Company from "Excelsior Enterprise Company" to the "National Company," and located the general office in the City of Philadelphia, Pennsylvania. The certificate of change was filed in the office of the Secretary of the Commonwealth on March 31, 1873.

Thereafter, the "National Company" actively engaged in business, and on January 1, 1874, when the new Constitution took effect, the Company possessed an existing charter, under which a *bona fide* organization already had taken place and business had been commenced in good faith.

The second installment of the bonus on capital stock was paid to the Commonwealth on the 20th of April,

1875, and the record of such payment appears on the books of the State Treasurer and the Auditor-General.

The records of the Company show that it has kept up and maintained its organization, has made the reports required to be made to the Commonwealth, and has paid all taxes assessed by the State under the general laws taxing corporations, these payments also being shown by the records of the Auditor-General and of the State Treasurer.

On November 9, 1896, stock having been increased to \$40,000,000, the first instalment of the bonus on this increase—\$49,875—was paid to the Treasurer of the Commonwealth of Pennsylvania, and his receipt therefor, registered and countersigned by the Auditor-General, was given to the Company.

These several facts above stated, and the several public records, are within the personal knowledge of Mr. Baer.

OPINION.

This Company, now known as the "READING COMPANY," possesses identically the same powers as the Pennsylvania Company. They are broad and liberal, and, in our opinion, are amply sufficient to justify you in the adoption of the Reading Company as the "New Company" proposed in the Plan and Agreement of Reorganization, and as the agency through which legally to carry the Plan into effect.

In our opinion, the READING COMPANY can legally acquire, receive and hold, and can mortgage and pledge, all the stocks, securities and properties, including the capital stocks of the New Railway Company, and of the Coal and Iron Company; and it can keep and perform all the covenants and conditions under which severally and respectively these two companies acquire their properties from the Purchasers. By a further increase of its capital, the READING COMPANY can legally issue the Common

and Preferred Stock, and the Bonds required by the Plan of Reorganization; and, to secure the payment of these bonds, it can lawfully pledge and mortgage the stock, securities and properties by it so acquired.

GEORGE F. BAER,
J. D. CAMPBELL,
THOMAS HART, JR.,
FRANCIS LYNDE STETSON,
VICTOR MORAWETZ,
JOHN G. JOHNSON,
SAMUEL DICKSON,
JAMES BOYD,
G. L. RIVES,
F. W. WHITRIDGE,
EDWARD M. PAXSON,
EDWARD J. PHELPS.

Opinion of Attorney General of Pennsylvania (Old Record, Government Exhibit 4, printed Vol. II, pp. 316-320).

OFFICE OF ATTORNEY GENERAL,
HARRISBURG, PA., January 2, 1897.

READING COMPANY:

This corporation was created by Act of the General Assembly of Pennsylvania, approved May 24, 1871, under the name of "Excelsior Enterprise Company."

By said Act of Assembly it was vested with all the rights, powers, privileges, franchises and immunities conferred by an Act of Assembly entitled "An Act to Incorporate the Pennsylvania Company", approved the 7th of April, 1870, and the supplements to said act. It was also given power by vote of the stockholders to change the name of the Company and to designate the location of its general office, and such changes were made valid after the filing of a certificate in the office of the Secretary of the Commonwealth, signed by the President and Secretary and attested by the seal of the said Company.

On May 25, 1871, it paid to the Commonwealth the first instalment of bonus on its capital stock. On January 18, 1873, as appears by certificate filed in the office of the Secretary of the Commonwealth, March 31, 1873, the name of the Company was changed from the Excelsior Enterprise Company to the National Company, and its general office was located in Philadelphia.

This department has also been advised, by transcripts of proceedings had in one of the courts of Philadelphia, that the name of the National Company has been duly changed to the **READING COMPANY**.

Pending the foreclosure proceedings under the general mortgage made by the Philadelphia and Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company, it came to the notice of this

department that a plan of reorganization was contemplated, by which it was proposed that the stock of the two companies above mentioned should be held, owned and controlled by the corporation originally known as the Excelsior Enterprise Company, since changed to READING COMPANY, as above mentioned.

The obvious purpose of this part of the scheme of reorganization seemed to be to escape from that provision of the Constitution of 1874 which forbids any incorporated company doing the business of a common carrier to directly or indirectly engage in mining or manufacturing articles for transportation over its lines; or, stated differently, the union of the coal company with the railroad company.

The charter under consideration grants powers of the most comprehensive character, and, if valid, enables the company to control and to engage in almost any business except that of a bank issue.

Upon examination of the records in the Auditor General's office it was learned that this corporation, although created in 1871, and constantly keeping up its organization, had practically done little or no business since the year 1875; and it was further learned that on or about November 9, 1896, the Company had increased its capital from \$100,000 to \$40,000,000, and had paid to the Commonwealth the first installment of bonus upon such increase, amounting to nearly \$50,000. It was announced also that a further increase of capital was contemplated to the amount of \$140,000,000.

The Attorney General then lodged with the State Treasurer and Auditor General a cautionary letter against receiving any further payments of bonus pending an investigation as to the power of the corporation to do the things proposed by it to be done.

By vote of the Company, the capital was increased further, as I am informed, from \$40,000,000 to \$140,000,000 and it was then learned by the Company that the

further payment of bonus would not be received by the State Treasurer until it could be demonstrated that the Company still possessed the powers claimed for it.

It was believed by the Attorney General that this Company fell within the provisions of Section 1, Article XVI., of the Constitution, which reads as follows:

"All existing charters, or grants of special or exclusive privileges, under which a *bona-fide* organization shall not have taken place and business been commenced in good faith at the time of the adoption of this Constitution, shall thereafter have no validity."

The counsel for the Reading Company voluntarily appeared before me on December 16, 1896, and produced certain evidence tending to show that a *bona fide* organization had taken place and business had been commenced in good faith some time prior to the adoption of the Constitution, which became operative January 1, 1874.

It appears from the minute book of the Company that the incorporators met pursuant to notice August 5, 1871, and organized. By resolution it was provided that a book to receive subscriptions to the capital stock be opened, and on that day a Treasurer was appointed for the incorporators with power to prepare and open such subscription book.

The next meeting of the stockholders appears to have taken place January 4, 1873, and subscriptions were made to the amount of \$50,000. On the same day there was a meeting of the Board of Directors, elected by the stockholders, and an election of President and Treasurer.

Another meeting of the Board of Directors was held January 8, 1873, at which the Treasurer of the Company reported that he had received \$10,000, being the amount paid on the stock subscribed, as above stated. On the same day the President, Secretary and Treasurer were by resolution requested to give the notice required by

the Act of April 21, 1858, to the Auditor General of the organization of the Company.

January 10, 1873, the Board of Directors again met, adopted by-laws, and authorized the purchase of a certain claim against the National Railway Company.

On January 11, 1873, a special meeting of the stockholders was held, at which a resolution was offered that the stockholders of the Excelsior Enterprise Company consent and agree that the capital stock of said Company shall be increased to 200,000 shares, and by vote increased the same to that amount, of which 100,000 shares were to be classed as common stock and 100,000 shares as preferred stock.

On January 13, 1873, the Directors met and authorized the purchase of 75,000 shares of the common stock of the National Railway Company in consideration of 100,000 shares of the common stock of the Excelsior Enterprise Company.

January 14, 1873, the Directors again met and transacted business, and again on January 18, 1873, at which meeting, on motion, the agreement submitted by counsel with the National and Stanhope Companies was accepted and the officers directed to sign and seal the same under directions of the Company.

On May 23, 1873, the Directors met and passed a resolution that the draft of the contract with the Philadelphia and Yardleyville Company for the construction of the Philadelphia and Yardleyville Railroad be approved and confirmed, and authorized the President and Secretary to execute the same on behalf of the Company. At the same meeting the draft of the contract with the National Railway Company of New Jersey was approved and the President and Secretary authorized to execute the same.

The Company also resolved at the same meeting to indorse and guarantee the bonds of the Philadelphia and Yardleyville Railroad Company to the amount of

\$1,500,000, and the bonds of the National Railway Company of New Jersey to the amount of \$3,500,000, and by said resolution did indorse and guarantee the same and directed the President and Secretary of the Company to execute said indorsement and guaranty upon said bonds.

The Directors again met on May 31, 1873, at which meeting was submitted a form of contract between the Victoria Construction Company and the National Company for building and equipping the railroads of the Philadelphia and Yardleyville Railroad Company and the National Railway Company of New Jersey.

On July 2, 1873, the Directors again met and authorized the Treasurer to receive from the Philadelphia and Yardleyville Railroad Company its bonds as the same shall become due to the Company in compliance with the contract.

On December 4, 1873, at a meeting of the Board of Directors, the National Company, formerly the Excelsior Enterprise Company, adopted and agreed to a contract with the Hamilton Land Association.

December 26, 1873, at a Directors' meeting, a communication was received, inclosing a proposal for the rebuilding of the National Railway from Bound Brook to the Delaware River, and referred to the Executive Committee. At the meeting the Secretary reported that the lease on building No. 218 South Fourth Street, Philadelphia, occupied by the Company, would expire on the 1st of January then next. On motion the Secretary was authorized to rent an office in Philadelphia. At the same meeting the Executive Committee was authorized to perfect details whereby the floating debt of the National Railway Company might be settled by preparing loan notes, if deemed advisable, due and payable on the 1st of January, 1875.

Other meetings were held February 4, 18 and 19, 1874, at which certain business was transacted. The Directors again met March 8, 1875.

On June 1, 1875, there was an annual meeting of the stockholders, at which Directors were elected, and the annual meetings have been kept up ever since, except in 1881 and 1882.

The only question for consideration is whether or not there was such a *bona fide* organization and commencement of business by the Excelsior Enterprise Company, now called the READING COMPANY, prior to January 1, 1874, as will prevent it from falling within the constitutional provision above cited.

That the Company was not successful in business seems clear enough, and I have little doubt but that it was used as a tributary to a more important corporation and for the purposes of the latter. But the Company was organized, did do business and incurred large obligations (many of them may be still outstanding) prior to January 1, 1874.

POWERS GRANTED BY STATE.

The powers written into the charter of the corporation, while, in my opinion, inimical to the best interests of the Commonwealth, are, nevertheless, powers granted by the State, accepted by the corporators, and acted upon by them, and those dealing with the Company. Nor do I think the non-use of the corporate franchises after 1875 for a long period is ground of forfeiture. The organization, as we have noticed, has been constantly kept up. The corporation is a private one, and the public had no interest in the use of the powers granted. The franchise to be a corporation was expressly retained by the annual elections of officers and appraisers never to have been abandoned.

After due consideration, I reach the conclusion, most reluctantly, that the Commonwealth of Pennsylvania cannot now successfully attack the chartered rights of the READING COMPANY; at least, the rights of such a nature

and character as had been exercised by the corporation prior to January 1, 1874. It had power to do the business in which it was engaged prior to the adoption of the new Constitution.

Whether the other grants of special privileges, of the varied kinds set forth in the charter, continued after January 1, 1874, is a question that may be determined hereafter, when the occasion arises. In construing a charter similar in character to that of the READING COMPANY in *Carothers' Appeal*, 118 Pa. St., 489, Mr. Justice WILLIAMS, speaking for the Court, used the following language:

"The question which we have is not whether a single corporation organized under an 'omnibus charter' may be permitted to gather up into one corporate hand all the powers and franchises of the Commonwealth, but whether this company may do this particular business in which it had embarked its capital. We hold that it may; that the powers granted by the act of incorporation authorized it to engage in this business."

My view of the whole matter is that the charter of the Company authorized it to do the kind of business in which it engaged prior to January 1, 1874, which business was of the same general character as that in which it proposes to engage for the purpose of controlling the stocks of the Railway Company and the Coal and Iron Company.

The wisdom of the framers of the Constitution of 1874, in denying to the Legislature the power to grant special charters, becomes painfully apparent in the consideration of the manifold powers granted by the charter of the Reading Company, and the only consolation of the present generation is that they are not responsible for it.

H. C. McCORMICK,
Attorney-General.

CONSOLIDATED STATEMENT
READING RAILROAD
COAL & IRON
MINING AND
INDUSTRIALIZATION.

For the year ended
" " " "
" " " "
" " " "
" " seven months
Railway Company
Coal & Iron Company

Less
Reading Company
Net Deficit
Total

STATEMENT OF SURPLUS
READING RAILROAD
PHILADELPHIA

For the year ended	READING COMPANY.	PHILADELPHIA	Surplus— per books.
June 30, 1898.....	\$ 133,293.12		.....
1899.....	650,719.63		.....
1900.....	1,227,935.95		\$ 745,309.20
1901.....	1,467,901.31		1,568,174.88
1902.....	1,239,911.71		2,794,587.05
1903.....	2,263,159.56		5,112,102.58
1904.....	4,125,299.80		7,028,368.06
1905.....	6,307,156.73		10,387,530.28
1906.....	8,794,398.45		9,772,001.89
1907.....	11,518,551.38		9,816,427.01
1908.....	14,269,445.94		10,162,066.44
1909.....	17,612,171.89		9,721,612.27
1910.....	20,094,021.20		11,372,906.09
1911.....	21,342,984.17		9,655,986.51
1912.....	22,608,626.72		8,765,980.04
1913.....	24,836,461.80		11,560,085.52
1914.....	27,259,203.69		8,426,178.10
1915.....	27,402,926.13		8,442,843.44
1916.....	28,459,405.70		14,867,839.46
Dec. 31, 1917 ¹	30,749,065.55		15,690,002.56
1918.....	32,559,035.00		10,780,898.74
1919.....	33,201,149.81		10,410,338.83
1920.....	33,996,983.01		10,113,114.23

¹ Fiscal year, which prior to this date ran from July 1 to June 30 annually—changed to period from January 1 to December 31 annually. Its first period covers eighteen months.

CONSOLIDATED STATEMENT OF THE EARNINGS FOR PHILADELPHIA & READING RAILROAD COMPANY AND THE PHILADELPHIA & READING COAL & IRON COMPANY FOR THE PERIOD PRIOR TO THE REORGANIZATION.

	Deficit—Excess of Expenses and Fixed Charges Over Earnings.
For the year ended November 30, 1893.....	\$ 802,343.00
“ “ “ “ November 30, 1894.....	1,933,007.00
“ “ “ “ November 30, 1895.....	1,538,805.00
“ “ “ “ November 30, 1896.....	1,365,846.00
“ “ seven months ended June 30, 1897	
Railway Company deficit.....	\$ 533,554.48
Coal & Iron Company “	1,141,700.10
	<u>\$1,675,254.58</u>
Less	
Reading Company Profit....	<u>432,127.64</u>
Net Deficit.....	<u>1,243,126.94</u>
Total Accumulated Deficit.....	<u>\$6,883,127.94</u>

STATEMENT OF SURPLUSES FOR THE YEARS 1898 TO 1920, INCLUSIVE.

READING COMPANY.	PHILADELPHIA & READING RAILWAY COMPANY.			THE PHILADELPHIA & READING COAL & IRON COMPANY.	AGGREGATE FOR 3 COMPANIES.	DIVIDENDS PAID BY READING COMPANY.
	Surplus— per books.	*Addition to property through income and surplus.	Total.			
\$ 133,293.12	.....	.....	.....	.....	\$ 133,293.12	.....
650,719.63	.....	.....	.....	\$ 423,038.30	1,073,757.93	.....
1,227,935.95	\$ 745,309.20	.....	\$ 745,309.20	280,253.15	2,253,498.30	\$ 374,735.25
1,467,901.31	1,568,174.88	.....	1,568,174.88	835,647.78	3,871,723.97	934,735.25
1,239,911.71	2,794,587.05	.....	2,794,587.05	652,116.12	4,686,614.88	1,120,000.
2,263,159.56	5,112,102.58	.....	5,112,102.58	1,422,361.02	8,797,623.16	840,000.
4,125,299.80	7,028,368.06	.....	7,028,368.06	1,222,788.09	12,376,455.95	2,590,000.
6,307,156.73	10,387,530.28	.....	10,387,530.28	1,390,666.16	18,085,353.17	3,850,000.
8,794,398.45	9,772,001.89	.....	9,772,001.89	1,259,920.54	19,826,320.88	5,600,000.
11,518,551.38	9,816,427.01	.....	9,816,427.01	1,188,438.52	22,523,416.91	5,600,000.
14,269,445.94	10,162,066.44	\$ 937,659.64	11,099,726.08	1,395,962.29	26,765,134.31	5,600,000.
17,612,171.89	9,721,612.27	2,743,381.82	12,464,994.09	1,462,936.00	31,540,101.98	5,600,000.
20,094,021.20	11,372,906.09	4,814,042.76	16,186,948.85	1,391,435.05	37,672,405.10	6,300,000.
21,342,984.17	9,655,986.51	8,167,601.58	17,823,588.09	1,288,118.49	40,454,690.75	7,000,000.
22,608,626.72	8,765,980.04	10,797,341.11	19,563,321.15	1,459,694.14	43,631,642.01	7,000,000.
24,836,461.80	11,560,085.52	13,188,903.47	24,748,988.99	2,509,286.55	52,184,737.34	7,700,000.
27,259,203.69	8,426,178.10	15,213,686.83	23,639,864.93	3,314,676.47	54,213,745.09	8,400,000.
27,402,926.13	8,442,843.44	16,375,378.15	24,818,221.59	3,375,248.45	55,596,396.17	8,400,000.
28,459,405.70	14,867,839.46	17,371,038.32	32,238,877.78	4,655,296.56	65,353,580.04	8,400,000.
30,749,065.55	15,690,002.56	21,968,947.76	37,658,950.32	11,986,307.04	80,394,322.91	12,600,000.
32,559,035.00	10,780,898.74	28,861,046.35	39,641,945.09	16,146,469.24	88,347,449.33	8,400,000.
33,201,149.81	10,410,338.83	33,383,185.76	43,793,524.59	19,013,206.00	96,007,880.40	8,400,000.
33,996,983.01	10,113,114.23	593,537.86	63,706,652.09	25,685,428.48	123,389,063.58	8,400,000.

ate ran from July 1 to June 30
ary 1 to December 31 annually.
s.

*Prior to June 30, 1907, the Railroad Company had charged additions to income; but thereafter the Interstate Commerce Commission required Additions and Betterments paid out of income to be capitalized.

Extracts from Annual Reports of the Philadelphia & Reading Railroad Company (Old Record, Vol. II, pp. 130-132).

From the annual report for 1887, pages 23 to 25, as follows:

At the annual meeting of the stockholders of the Philadelphia and Reading Railroad Company, held January 9, 1888, the following resolutions were unanimously adopted by a vote of 794,895 shares:

RESOLVED, That the report of the president and board of managers for the year ending November 30, 1887, just read, be accepted and adopted, and, together with the accompanying exhibits and documents of the receivers, be printed in pamphlet form for distribution among the shareholders.

RESOLVED, That an issue of general mortgage bonds of the Philadelphia and Reading Railroad Company is hereby authorized to the amount of one hundred million of dollars, bearing interest at a rate not exceeding four per cent per annum, and that a mortgage dated January 3, 1888, in such form as may be approved by the board of managers, be executed securing the same, upon the railroads, leased lines, rolling stock, ships, boats, real estate, and franchises of the company, now or hereafter acquired, and the coal lands and other real estate, plant and leasehold estates, now or hereafter acquired, of the Philadelphia and Reading Coal and Iron Company.

RESOLVED, That an issue of first preference income mortgage bonds of the Philadelphia and Reading Railroad Company is hereby authorized to an amount not exceeding \$25,000,000 payable January 1, 1958, bearing non-cumulative interest from June 1, 1887, at five per cent per annum, payable only out of earnings available for the purpose, after providing for interest on the general mortgage bonds and all other fixed charges, and that a mortgage dated January 3d, 1888, in such form as may be

approved by the board of managers, be executed securing the same, upon the railroads, leased lines, rolling stock, ships, boats, real estate, and franchises of the company, now or hereafter acquired, and the coal lands and other real estate, plant, and leasehold estates, now or hereafter acquired, of the Philadelphia and Reading Coal and Iron Company, said mortgage to be subordinate in lien to the mortgage given to secure the general mortgage bonds.

RESOLVED, That an issue of second-preference income mortgage bonds of the Philadelphia and Reading Railroad Company is hereby authorized to an amount not exceeding \$26,140,518, payable January 1, 1958, bearing non-cumulative interest from June 1, 1887, at five per cent per annum, payable only out of earnings available for the purpose, after providing for interest on the general mortgage bonds, and all other fixed charges and interest on the first-preference income mortgage bonds, and that a mortgage dated January 3, 1888, in such form as may be approved by the board of managers, be executed securing the same, upon the railroads, leased lines, rolling stock, ships, boats, real estate, and franchises of the company, now or hereafter acquired and the coal lands and other real estate, plant, and leasehold estates, now or hereafter acquired, of the Philadelphia and Reading Coal and Iron Company, said mortgage to be subordinate in lien to the mortgages given to secure the general mortgage bonds and the first-preference income mortgage bonds.

RESOLVED, That an issue of third-preference income mortgage bonds of the Philadelphia and Reading Railroad Company is hereby authorized to such an amount as the board of managers may from time to time determine, payable January 1, 1958, bearing noncumulative interest from June 1, 1887, at five per cent per annum, payable only out of earnings available for the purpose, after providing for interest on the general mortgage bonds and all other fixed charges, and interest on the

first-preference income mortgage bonds, and on the second-preference income mortgage bonds, and that a mortgage dated January 3, 1888, in such form as may be approved by the board of managers, be executed securing the same, upon the railroads, leased lines, rolling stock, ships, boats, real estate, and franchises of the company, now or hereafter acquired, and the coal lands and other real estate, plant, and leasehold estates, now or hereafter acquired, of the Philadelphia and Reading Coal and Iron Company, said mortgage to be subordinate in lien to the mortgages given to secure the general mortgage bonds, and the first and second preference income mortgage bonds.

From the annual report for 1891, page 15, as follows (Old Record, Vol. II, p. 132) :

It may be of interest to those who are not familiar with previous reports to add that the immense estates of the company aggregate upwards of 194,000 acres, which may be classified as follows:

Coal lands owned (acres).....	95,144	
Coal lands leased from others (acres)	7,429	
		<hr/> 102,573
Timber lands owned (acres).....	70,489	
Iron-ore lands (acres).....	21,000	
		<hr/> 194,062
Total area (acres).....		194,062

The coal lands comprise in extent about 33 per cent. of the entire anthracite coal fields of the State, and taking into account the aggregate thickness of the veins on the company's lands, and the greater proportionate depletion of the estates in the other regions which has been going on for many years, it must be conceded that we have at least 50 per cent. of the entire deposit remaining unmined.

From the annual report for 1893, page 11, as follows (Old Record, Vol. II, p. 136) :

It should, perhaps, be stated here that although the operations and the organization of the Philadelphia and Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company are and have always been entirely distinct, their joint interest will in this report be treated of together, as they are so intertwined—the coal and iron company mining and marketing the coal which the railroad company transports—that it will conduce to convenience and clearness of statement to so consider them.

From the annual report for 1893, pages 77 and 78, as follows (Old Record, Vol. II, pp. 137, 138) :

For the last quarter of a century the maintenance of the integrity of the Reading System as a whole, and the preservation of the franchises of both the railroad and coal and iron companies so as to develop and operate the properties of both companies to advantage, have been regarded as of cardinal importance to all interested, either as creditors or as stockholders. No inventory and appraisement of separate items are of any importance, except so far as a statement of these assets may give an assurance of the permanence and growth of the income, unless it is proposed to sell the property in parcels, and such a method of realizing its value has never been seriously proposed. In fact, by the ninth article of the general mortgage of January 3d, 1888, it is provided “the railroad company and coal company for themselves and for all persons and corporations lawfully claiming through or under them, respectively, or who may at any time become holders of liens junior to the lien of this mortgage, hereby expressly waive and release all right to have the mortgaged property marshaled upon any sale

thereof under the provisions of this mortgage; and the trustee hereunder and any court in which foreclosure of this mortgage is sought shall sell the entire mortgaged and pledged property of every description in each case as a whole, subject to the right of a majority in interest of the holders of the bonds hereby secured then outstanding, by requisition in writing, to direct the trustee to sell said properties in such parcels as they may deem best."

This provision is the best evidence of the opinion entertained by all concerned in the reorganization of 1888 as to the proper manner in which to deal with the property in case it should prove necessary to sell under foreclosure, and the concessions at that time to the holders of the securities of the Susquehanna and Schuylkill Canal Companies and other unproductive properties were only made because of the value attached to the preservation of the franchises and of the unity of the system.

It is thus manifest that any plan for the reorganization of the affairs of the Reading Companies must be based upon the maintenance of the property as an entirety and as a going concern; and this being so, it is essential that provision should be made for—1st, the payment of the interest upon the general mortgage bonds; 2d, the payment of the liabilities incurred in the purchase of equipment; and 3d, the funding of the floating indebtedness, including the receivers' certificates.

From the annual report for 1894, page 9, as follows (Old Record, Vol. II, p. 138) :

The management have always felt that of all branches of the business of the Reading Companies the most important and the most promising is the production and

sale of anthracite. In all other departments the Reading Companies compete with rivals who are placed and equipped for business as well as or better than themselves, but in the coal business they have a vast undeveloped estate, which needs only time, patience, and resolution to develop profitably. To this development, both in producing and marketing the coal, they have devoted their best energies.

From the annual report for 1895, page 7, as follows (Old Record, Vol. II, p. 139) :

As the Coal and Iron Company did not earn its operating expenses, it became necessary for the railroad company to advance to it the money required to pay so much of its interest as is guaranteed by the railroad company, which is \$656,270.

From the annual report for 1895, page 11, as follows (Old Record, Vol. II, p. 139) :

While the business was a losing one for the coal and iron company, this loss was more than made up by the gain to the railroad company from the additional tonnage produced, which was carried at freight rates which yielded a profit.

From printed report of the committee appointed by the stockholders to investigate the Philadelphia and Reading Railroad Company, January 12, 1885, pages 37 to 43, as follows (Old Record, Vol. II, pp. 127-130) :

HISTORY AND POLICY OF ACQUISITION OF COAL LANDS.

Up to the year 1870 your company had confined its business exclusively to the transportation of passengers, coal, and other merchandise. In that year, however, there

took place serious labor strikes in the coal territory, to prevent a recurrence of which evil your managers conceived the idea of becoming, through the ownership of an auxiliary company, "the owners of coal lands situate upon the line of its several branches" (see report, January 8, 1872, page 16), believing that a closer relationship to the labor than through the miner and shipper would enable your company to control the question and prevent these periodical strikes. The result of this action was (see page 17), "to secure, and attach to the company's railroad, a body of coal land capable of supplying all the coal tonnage that can possibly be transported over the road for centuries," and your managers added: "This result has been obtained without imposing any serious burden upon the company, for the lands purchased are already so far developed that it is estimated they will produce in rents, during the year 1872, \$1,200,000; and it is believed that in less than three years the net annual revenue arising from the lands will be greater than the interest payable upon the loan issued to secure them;" but unfortunately the vicissitudes of this commercial undertaking have, as we shall see, prevented the fulfilment of the prophecy; for in the very next year your managers (report of January 13, 1873, page 18) admit that although the coal tonnage was greater than in any previous year, yet the gross receipts had fallen off, owing to a decline in the price of coal and rates of transportation which the company, notwithstanding its acquisition of the coal fields, was "unable to control." During this year, 1872, your managers purchased 10,000 additional acres, making 80,000 acres in the aggregate controlled, "upon which there were ninety-eight collieries"; and they stated, among other things (see page 31): "Should the anticipations formed of the coal trade for the coming season prove correct, the managers believe that the Coal and Iron Company will, during this year, which is but the second of its existence,

be in the receipt of an income sufficient to pay the interest upon the entire cost of its property."

About this time a policy inaugurated originally to prevent strikes and furnish traffic grew into one to prevent competition and secure control, and in 1874, 20,000 additional acres were acquired (see report of January 11, 1875, page 26), upon the consummation of which negotiation your managers announced that it "was not at present designed to purchase any more." (By way of parenthesis it may be here mentioned that the aggregate number of acres was thus augmented to 100,000, and that since that declaration it has reached 163,290 acres.)

Having now secured the territory, the coal and iron company embarked regularly and systematically into the business of mining, preparing, and shipping coal (see same page), and your managers gave as their reasons therefor, as follows: "An experience of one or two years as landlords showed how utterly inadequate, under existing circumstances, the individual tenants were to develop and improve the estate;" first, because they had not sufficient capital to mine properly; and, second, because the depression resulting from the strikes had given little encouragement to individuals to engage in mining. Therefore, your managers resolved (page 27) to become miners of the coal themselves; and for this purpose, in addition to "expenditures for purchasing, opening, and improving collieries," they go on to say, "a large investment was made, outside of the coal regions, to enable them to handle and successfully dispose of the product of the mines. Large retail yards in the city of Philadelphia, wharves, and shipping facilities in New York and the various eastern ports have been purchased and erected; and it is believed that no other company now possesses greater advantages than those of the Philadelphia and Reading Coal and Iron Company, in the ability to mine coal economically, and to dispose of a large product to

the best advantage; the only improvement yet wanted to complete the system being a depot capable of storing at one place at least 500,000 tons of coal, in order to keep the collieries constantly at work and avoid the expense of stopping them whenever orders are scarce, or vessels not in sufficient supply to carry away the products."

At page 29 of the same report (for 1874) is found this statement:

"When it is considered that the anthracite coal trade of the United States has now reached an annual product of 19,000,000 of tons, that is, has doubled every ten years during the past; that in ten years it will be 40,000,000 of tons; and that the Philadelphia and Reading Coal and Iron Company owns at least one-third of all the anthracite coal land of Pennsylvania, but little doubt can reasonably be entertained of the future success of the company." Upon such theories and hopes was the financial administration of your property based.

Instead, however, of reaching 40,000,000 of tons in ten years, the production, owing in a great measure to the depression of all classes of industry, aggregated only 30,000,000, and instead of the coal and iron company producing 13,333,333 tons, which would be one-third of 40,000,000, it produced in the year terminating the decade (1884) only 5,672,685 tons.

This is an illustration of the danger of basing financial schemes on "the substance of things hoped for, the evidence of things not seen."

In the report of January 10, 1876, page 16, your managers tell you "the principal feature in the business of the past season, and the cause of the largely decreased traffic, has been a prolonged strike in the anthracite coal region, which for six months deprived the company of nearly its entire coal tonnage and very materially reduced its receipts from other traffic which is always dependent upon the coal trade."

Thus the primary object for which these lands were acquired, to wit, to guard against strikes, resulted in an universal stoppage of work over the entire region, whereas in previous years these combinations had been confined to localities. This strike which for six months defied the power of the company and snapped its fingers at its ownership and control of the coal lands, cost your company upwards of four and a half millions of dollars, and was terminated only by the zeal and intelligence brought to bear upon it by your then president, and the courage of his trusty subordinates. It was the power of these determined men, and not the potency of the wealth and magnitude of your estate, which restored tranquility and trade and punished the transgressors.

In the report made January 8, 1877, page 18, your managers stated that "the net profits of your company" were \$1,355,708.58 short of paying the fixed charges; and that this result was "not alone due to the great depression in business and the depreciation of values, but that it was caused, to a very great extent, by the unfair workings of the association of coal producing and transporting companies by which the company, in the months of June, July, and August was practically deprived of its proper share of coal tonnage, and was, for the time being, unable to protect itself."

Thus we gather from the history of your company, written by its own managers, that in the brief period of half a decade, it was demonstrated that in associating with transportation the precarious business of producing and manufacturing, the very objects which this policy was inaugurated to attain were defeated, viz:

- 1st. To prevent strikes.
- 2d. To provide its proper share of tonnage, and
- 3d. To control the price of the commodity.

What would have been the result of confining your business to the functions for which you were originally

created is idle to speculate about at this late date. Perhaps it would have been better.

To retrace your steps is impracticable, if it were policy to do so; you are too heavily handicapped by the obligations incurred during the past fifteen years; and until you are relieved from their weight you will be in no condition to engage in competition with your less burthened rivals.

Your committee feel that they should emphatically enter a protest against any further purchase of coal lands, and they are constrained to do this because they find that during 1883 and as recently as 1884 (under contracts made in 1883), notwithstanding the embarrassed condition of your property, you purchased the following:

* * * * *

We are confirmed in our view upon this subject by the following extract from the testimony taken before your committee of the officer of the company most familiar with the subject:

“Q. Are you of opinion that the Reading Railroad has acquired all the coal land which menaced or threatened its business of transportation, if in rival hands?

“A. Yes; all that was available; I don't know where another road could get any coal at all in the southern coal field.”

There may be and probably is good reason why a system of railroad traversing a territory abounding in a production indigenous thereto should secure beyond all hazard its carrying share thereof.

To so secure your traffic that you are at all times powerful enough to engage in honest competition is a duty; but to step beyond this is not only an expensive experiment which seldom succeeds, but oftener leads to embarrassment and disaster; especially in a country pregnant with new developments and fertile in ingenuity to thwart all combinations against competition.

*List of fifty largest stockholders at close of business
March 16, 1914 (Old Record, Vol. II, p. 431).*

	1st pref. shares.	2nd pref. shares.	Common shares.	Total shares.
Lake Shore & Mich. Sthn. Ry. Co., Grand Cen. Ter., New York City.....	121,300	285,300	200,050	606,650
Balto. & Ohio R. R. Co., Baltimore, Md.....	121,300	285,300	200,000	606,600
P. A. B. Widener, Land Title Bldg., Philadelphia.....			100,000	100,000
Whitehouse & Co., 111 Broadway, N. Y. C.....	9,295	23,436	11,756	44,487
Pyne, Kendall & Hollister, 55 Wall St., N. Y.....			31,580	31,580
Huhn, Edy & Co., 111 Broadway, N. Y.....	400		29,800	29,700
George F. Baker, 2 Wall St., New York.....			17,500	17,500
A. Iselin & Co., 36 Wall St., New York.....	14,377	1,300	1,350	16,727
Oliver H. Payne, 51 Wall St., New York.....			15,000	15,000
Est. of Thos. McKean, Drexel Bldg., Phila.....	11,450		3,400	14,850
Henry Graves, jr., 80 Broad St., New York.....	9,000	4,000		13,000
Pomeroy Bros., 30 Pine St., New York.....		12,000	700	12,700
John B. Manning, 2 Wall St., New York.....	1,170	2,557	8,907	12,634
J. W. Davis & Co., 100 Broadway, N. Y.....	264	100	11,790	12,054
Hancke Hencken, 8 W. 121st, N. Y.....		9,300	2,400	11,600
George F. Baer, Reading Terminal, Phila.....	7,658	587	3,622	11,867
Homans & Co., 2 Wall St., New York.....			11,400	11,400
Moore & Schley, 80 Broadway, N. Y.....			10,820	10,820
Pearl & Co., 71 Broadway, New York.....			10,710	10,710
Lehman Bros., 16 William St., N. Y.....	1,720	2,768	5,180	9,618
Charles D. Barney & Co., 25 Broad St., New York.....			9,375	9,375
Vivian Gray & Co., London, E. C., Eng.....			9,060	9,060
George A. Huhn & Sons, Land Title Bldg., Phila.....			8,700	8,700
S. Japhet & Co., London, E. C., Eng.....			8,110	8,110
Halle & Stieglitz, 30 Broad St., N. Y.....			7,975	7,975
J. S. Bache & Co., 49 Broadway, N. Y.....		4	7,610	7,614
Arthur Lipper & Co., 20 New St., New York.....		800	7,029	7,229
Dexter P. Rumsey, Buffalo, N. Y.....			7,200	7,200
Cornelius A. Lane, 1211 Clover St., Phila.....	400	1,700	5,000	7,100
Strong, Sturgis & Co., 30 Broad St., New York.....			7,066	7,066
Henry Graves, 30 Broad St., New York.....	1,000	6,000		7,000
Emily A. Watson, 512 5th Av., N. Y.....	7,000			7,000
Stephen Sanford, Amsterdam, N. Y.....				6,954
Henry Clews & Co., 25 Broad St., New York.....				6,515
Keech, Loew & Co., 7 Wall St., N. Y.....	68	300	6,250	6,270
Geo. D. Widener, est., Land Title Bldg., Phila.....		20	6,111	6,111
James G. Kitchen, 8 Letitia St., Phila.....			6,000	6,000
Geo. Eastman, Rochester, N. Y.....	900	2,700	2,500	6,100
Park M. Woolley, 77 Spring St., N. Y.....			6,000	6,000
Joseph A. Woolley, 77 Spring St., N. Y.....			6,000	6,000
Edward H. Graves, 30 Broad St., New York.....			6,000	6,000
M. C. Bouvier & Co., 30 Broad St., New York.....	2,800	2,620		5,420
J. J. Danzig & Co., 100 Broadway, N. Y.....		100	5,275	5,375
Shearson, Hamill & Co., 71 Broadway, N. Y.....			5,300	5,300
S. B. Chapin & Co., 111 Broadway, N. Y.....		300	4,950	5,250
Nathan Snellenburg, 18th & Market Sts., Philadelphia.....	20		5,196	5,216
Wm. M. Potts, Wyebrook, Pa.....		200	5,000	5,200
Frank W. McElroy, Frick Bldg., Pittsburgh, Pa.....	1,000	2,100	2,000	5,100
Florence A. V. Twombly, 684 5th Ave., N. Y.....	5,000		5,000	5,000
Jos. E. Widener, Land Title Bldg., Phila.....			5,000	5,000

Dated November 2, 1921.

ABRAM F. MYERS, for the
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Plan as Modified.

(Filed May 12, 1921.)

In pursuance of the decree of mandate of this Court entered October 8th, 1920, defendants, Reading Company, Philadelphia and Reading Railway Company, and The Philadelphia & Reading Coal & Iron Company, respectfully submit the following plan:—

1. The Reading Company will assume the \$96,524,000 General Mortgage 4% bonds, which are a joint obligation of the Reading Company and The Philadelphia & Reading Coal & Iron Company (hereinafter called the Coal Company), and will agree to save the Coal Company and its property harmless therefrom.

2. The Coal Company will pay to the Reading Company \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in 4% mortgage bonds of the Coal Company. The mortgage under which they are to be issued may contain provision for the issue thereunder of additional bonds to provide for additions, betterments and improvements to a limited amount, to be determined by the Reading Company and the Coal Company prior to the creation of the mortgage, and shall contain provision for a proper sinking fund for the retirement of bonds issued thereunder. The \$25,000,000 bonds issued by the Coal Company to the Reading Company shall mature on January 1, 1997, the same date as the General Mortgage bonds. The bonds issued by the Coal Company shall be subject to redemption at par and accrued interest on any semi-annual interest date as a whole but not in part, except out of the moneys in the sinking fund.

3. Except as otherwise herein expressly provided, general releases of all claims and liabilities as between the Reading Company and the Coal Company, including the claim of approximately \$70,000,000 carried on the books of the Reading Company as an asset and on the books of the Coal Company as a liability, will be exchanged.

4. *The Reading Company will agree with the Coal Company that, at or before the maturity of the General Mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the General Mortgage and the discharge of the Coal Company from liability on the General Mortgage bonds.*

5. *If the Court so orders, the Reading Company will, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company, including the present right to vote and receive dividends thereon, to a new corporation to be formed with appropriate powers, and will agree to save the new corporation and said stock harmless from the lien of the General Mortgage, and will agree to obtain, at or before the maturity of the General Mortgage, the release of the stock of the Coal Company from the lien of the General Mortgage and the assignment, transfer and delivery of said stock to the new corporation—all in consideration of the payment by the new corporation to the Reading Company of the sum of \$5,600,000, and its agreement to issue its shares to the stockholders of the Reading Company as hereinafter provided. The new corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each share of Reading stock. Provision will be made for the disposition by the Reading Company of any rights to subscribe which may not be availed of by the Reading stockholders within such period as may be fixed by the Reading Company, with the approval of the Court, to the end that the new corporation shall receive the full purchase price of \$5,600,000. It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific-Southern Pacific case, by issuing to Reading stockholders, with or without the in-*

tervention of a trustee, as may be provided for in the final decree of the Court, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company.

In addition there will be embodied in the final decree a permanent injunction against the new corporation exercising its voting power on the stock of the Coal Company in such a way as to bring about any new relations between the Coal Company and the Reading Company of the character complained of in the present suit. Any further steps, which may be deemed necessary by the Court, will be taken to the end that an independent board and management to be approved by it will be maintained for the Coal Company, so that the independence of this company need not await the necessarily gradual process of the distribution of the no par value stock of the new corporation among persons not holders of stock in the Reading Company.

The final decree may provide that if by reason of default on the General Mortgage bonds the Trustee, the Central Union Trust Company, shall exercise the right to vote the stock of Reading Coal Company, it shall so exercise that right as not to bring about unity of management between said Coal Company and Reading Company, and the final decree may further provide that, in the event the Trustee at any time is obliged to sell the stock or properties of Reading Coal Company, it shall dispose of such stock and properties separately from the properties of Reading Company and to different interests.

6. The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage. The name of the Reading Company, after merger, will not be changed. The Reading

Company will accept the Pennsylvania Constitution of 1874, and it will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated.

7. The Court will be asked to defer the actual sale of the stock held by the Reading Company in the Central Railroad of New Jersey pending the grouping of railroads by the Interstate Commerce Commission under the Transportation Act, but subject to the further order of the Court. It is assumed that the Attorney General will ask the Court to make an order assuring the voting of the stock pending such sale in the manner approved by the Court. A detailed plan for the prompt disposition of the stock of the Lehigh and Wilkes-Barre Coal Company by the Central Railroad of New Jersey has been submitted separately.

READING COMPANY,
By
CHARLES HEEBNER,
General Counsel.

WM. CLARKE MASON,
Solicitor.

R. C. LEFFINGWELL,
Counsel.

Approved on behalf of the United States,

ABRAM F. MYERS,
Special Assistant to the Attorney General.

(The objection of the Attorney General to the provisions of paragraph 7, and also the plan for the sale of the stock of the Lehigh and Wilkes-Barre Coal Company remain the same as in the original plan.)

Opinion.

(Filed May 21, 1921.)

BEFORE BUFFINGTON AND DAVIS, CIRCUIT JUDGES, AND
THOMPSON, DISTRICT JUDGE.

BUFFINGTON, J.

On the return to this Court of the mandate of the Supreme Court of the United States directing, *inter alia*, this Court to enter a decree "dissolving the combination of the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, *with such provisions for the disposition of the shares of stock and bonds and other property of the various companies*, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia and Reading Railroad Company, the Philadelphia and Reading Coal and Iron Company", etc., we called before us the counsel for the United States and the counsel for the Reading Company and directed the latter, in consultation with the former, to formulate a dissolution plan in conformity with the said mandate. In accordance with these directions, and after consultation by all of said counsel from time to time with the Court, a tentative plan was eventually drafted and placed on file in the Clerk's office, for the inspection of all parties concerned. Subsequently, the Court gave a hearing to all parties who desired to be heard and signified its willingness to receive for consideration, petitions to intervene. Numerous parties and representatives of various interests having thus been heard and numerous briefs having been filed showing the views of the parties concerned, the Court was thereby placed

in possession of such information as enabled it to determine what parties should be allowed to intervene and also to formulate such questions, issues and objections to the proposed plan as would afford a basis for an enlightening and constructive discussion on the part of all parties of record. Accordingly, this Court, by its order of April 12th, 1921, directed it would on May 2d, 1921, hear arguments on the following questions:—

“1. (a) Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of the Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful: (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

“2. Whether the stock of the Coal Company should be sold free from the lien of the General Mortgage, or whether a sale of Certificates of Interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

“3. Whether the Reading Company should offer a premium of ten per cent. to the General Mortgage bondholders for release of the Coal Company's property from lien of the mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause,”

and directed that all parties who desired to be heard should file briefs on April 30, 1921, containing in substance their proposed arguments. Having thus in advance the advantage of the proposed arguments, the Court

found on the day set for argument that, due to a modification of the plan agreed to by the Attorney General of the United States, the counsel for the Reading Company and counsel representing certain holders of bonds secured by the General Mortgage of the Reading Company, substantially all of the above questions were disposed of save those arising under sub-division *b* of the first question. And this feature, briefly stated, resolved itself into an issue as to the relative rights of the preferred and common stock of the Reading Company, arising out of the disposition of the stock of the Philadelphia & Reading Coal & Iron Company, which latter stock was owned by the Reading Company. The stock of the Philadelphia & Reading Coal & Iron Co. so owned by the Reading Company has a par value of eight millions of dollars. It will be noted that this stock holding by the Reading Company in the Coal Company was decreed by the Supreme Court an unlawful holding and was one as to which the Supreme Court directed this Court to enter a decree "with such provision for the disposition of the shares of stock and bonds and other properties of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company", etc. In the plan proposed this order was complied with in that the offending stock was, under proper restrictions and elections, to be disposed of to all the stockholders, both common and preferred, of the Reading Company. By this stockholding passing from the ownership of the Reading Company and being vested in the disassociated ownership of the individual stockholders with such provisions for safeguarding against an unlawful combination between them as is provided in the proposed decree, and as will be hereafter described, it will be seen the letter and spirit of the mandate of the Supreme Court are complied with. The offending stock passes out of the

ownership of the unlawful holder and neither it nor the proceeds of its sale can be hereafter used in unlawful combination. In that connection it will be noted that the mandate directs a "disposition of shares of stock and bonds and other property held by the Reading Company", and in that respect the mandate has been complied with precisely, in that there has been a "disposition" of the stock, it being taken from the Reading Company, and it has not even been distributed by that company, but, treated as an unlawful holding of that company, it is to be taken by the Court and disposed of absolutely by it, by sale through the agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it. The mere circumstance that those persons are stockholders of the Reading Company is attributable to the fact that in the application of equitable principles and without sacrifice of the spirit of the mandate, they compose a class of suitable recipients, in the manner above stated, of the stock which was unlawfully held by the company of which they were stockholders. In other words, if the carrying out of the mandate had necessitated the use of this stock to reduce, for example, the bonded or other indebtedness of the Reading Company, the stockholders of that company, which unlawfully held the stock to be disposed of would have no claim in law to prevent such disposition. From these considerations it is apparent that whatever this disposition of the stock may be called, it is in no sense an earning of the Reading Company which is to be disposed of by that company as a dividend. It is a taking by the law of an asset of that company, a stock asset, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself. Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved, and in that connection we deem

it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings.

Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. We are therefore of opinion that the plan which embodies these equitable principles should be approved and that the claim of the common shareholders to take all of this stock to the exclusion of the preferred stockholders should be denied. And in approving such plan we note that in point of fact the equity of a common participation of all stockholders, preferred and common, has not only the approval of the Government of the United States that has no interest in the controversy, save to see that equity is done to all; of the Reading Company which has no interest save an impartial stewardship for all its shareholders; and lastly the silently expressed approval of substantially two-thirds of the shares held by common stockholders. This significant and impressive fact cannot but be regarded as highly persuasive of the substantial equity of this plan. Of the 1,400,000 shares of the common stock of the Reading Company, less than one-third object to it. The other two-thirds, having had the opportunity to object and failing to do so, we are warranted in treating as acquiescing in the proposed

plan. Indeed, we are justified from one circumstance in concluding from the positive attitude of a hundred thousand of those shares that the remainder are not only passively acquiescing but really actively approving. This particular block of a hundred thousand shares of the common stock is represented by one man who is a trustee of an estate which owns it and he himself is the owner of one-half of such trust estate. He or the estate have no preferred stock whatever. He is also a Director of the Reading Company and as such favored the plan. By his counsel he appeared at the hearing and strongly urged its adoption, asserting his consent to the preferred stock sharing equally with the common in the disposition of the shares of the Coal Company. His contention was that this equal participation by common and preferred stockholders was not only fair, legal and equitable, but that such a proportionate division tended to the welfare of all parties concerned and indeed was a course which made the plan possible. When it is considered that the non-participation of the preferred stockholders in the shares of the Coal Company and the absorption of all the stock by the common shareholders would have benefited this particular hundred thousand shares by a large sum, this Court may rest assured that the proposed plan by its equality works equity. Without entering upon a further discussion of the questions involved, we are of opinion, after careful and matured consideration, that the plan as amended should be approved and we therefore direct the preparation of a formal decree embodying its terms. We deem it proper to add that such decree shall provide for the creation of a new corporation, to which shall be sold the equities in the shares of the Philadelphia & Reading Coal & Iron Company held by the Reading Company. The rights to purchase the stock of this newly created company will be sold to the preferred and common stockholders of the Reading Company share and share alike. In the creation of such a

corporation by this Court's order, we follow a general course pursued in the case of *United States vs. Du Pont, et al.*, 188 F. R., 127, and the wisdom of so doing will be seen by an examination of the opinion lately filed in that case, where the purpose of such procedure is fully explained. By the creation of this new corporation by the directions of this Court and by its retention of jurisdiction to enforce this decree as therein provided, the Court can, if such contingency should arise, by its control of this newly formed corporation, control all of its stockholders and prevent such stock from ever being used to thwart the decree made in pursuance of the plan.

The paragraph of the original Reading Plan numbered eight, which is paragraph numbered seven of the plan as modified in accordance with the agreement between Reading Company and the Attorney General of the United States as of May 12, 1921, contains the only provision in the plan proposed to carry out the mandate of the Supreme Court of the United States which is not agreed to in all of its details by the Reading Company and the Attorney General, and as to this provision of the plan the disagreement relates only to a matter of time.

The section referred to concerns the disposition by the Reading Company of the stock of the Central Railroad of New Jersey owned by the former, and as to this disposition Reading Company and the Attorney General agree, that the stock shall be transferred to one or more trustees, individual or corporate, to be held and voted under the terms of the trust until sold to a purchaser other than the parties defendant in this cause.

Reading Company contends that the spirit and the letter of section five of the Interstate Commerce Act, as amended by the Transportation Act of 1920, justifies its prayer that the value of this stock of the Central Railroad Company of New Jersey shall not be subjected to possible sacrifice by a sale until the Interstate Commerce

Commission shall adopt a consolidation plan which will designate the several railroads of the East with which the Central Railroad Company of New Jersey may be consolidated, so that assurance may be given to a railroad company purchaser of this stock that the holding of it by such purchaser will not be objectionable.

The Attorney General has contended that the stock should be placed in the hands of a trustee or trustees under a decree of this Court which shall direct Reading Company to proceed with all due diligence to offer the same for sale within a definite period, and if at the expiration of such period a purchaser has not been found by Reading Company, then upon the application of the Attorney General the Court may decree a sale of this stock at public auction or in such manner as the Court shall then provide.

The Court is of opinion that because of the provisions of the Transportation Act of 1920 there is presently no prospective purchaser of the Jersey Central stock at a fair price, and so long as the control of the voting power of this stock is taken from Reading Company and lodged with a trustee or trustees, acting under the supervision of this Court, there is full compliance with the mandate of the Supreme Court, which requires that there shall be established entire independence between these two companies, and we are also of opinion there is no good reason why the decree of this Court shall now subject the stock to the possible sacrifice of a forced sale to the detriment not only of the Reading Company but also to the almost equal number of other shareholders of the Jersey Central who are not parties to this record, who have no right to be heard and yet who may be very seriously affected by a decree of this Court ordering at the present time, a forced sale of this majority stock.

The final decree to be entered herein, therefore, will direct the transfer of the stock of the Central Railroad

Company of New Jersey, owned by Reading Company, to such trustee or trustees, individual or corporate, as the Court may name, and shall contain the terms of the trust, which in substance shall provide that the stock shall be voted by the trustee or trustees so that at all times there shall be entire independence of directors and management between Reading Company, as it shall be hereafter merged with Reading Railway Company, and the Central Railroad Company of New Jersey; and that pending a sale of the stock all dividends received by the trustee or trustees upon the same shall be paid to Reading Company or as it shall direct, and that the actual sale of the stock of the Central Railroad Company of New Jersey shall be deferred in view of the possible grouping of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, subject, however, to a provision in the decree that on motion of the United States or other party, or upon the Court's own initiative, that without awaiting such action by the Interstate Commerce Commission, an order may be entered hereafter, for the sale of such stock, if and when it shall appear to the Court that the facts require it, or the situation makes it possible.

It is, therefore, ordered that counsel for the Reading Company, and the Attorney General of the United States, shall prepare and submit to the Court within fifteen days a form of Decree to make effective the mandate of the Supreme Court of the United States in the above entitled cause, in accordance with the provisions of the modified plan agreed to by the Reading Company and the Attorney General of the United States and in conformity with this opinion.

Decree.

(Filed June 6, 1921.)

A decree of this Court having been entered in the above cause on October 28, 1915, and the said cause having been appealed by both parties to the Supreme Court of the United States, and that court having affirmed in part and in part reversed the decree of this Court, a mandate from the Supreme Court containing directions as to the decree to be entered was filed herein on the 13th day of August, 1920.

On October 8, 1920, this Court entered an interlocutory decree by which it was ordered "That within ninety days from the entry of this decree the defendants shall submit to this Court a plan for the dissolution of the unlawful combination between Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law."

Thereafter the time within which to present said Plan was extended by this Court until February 14, 1921, on which date a Plan was filed herein pursuant to said interlocutory decree, a counter-proposal filed by the United States to paragraph 8 of said Plan (paragraph 7 of the modified Plan) and an order entered directing that a

copy of said Plan be served upon the Central Union Trust Company of New York, Trustee under the General Mortgage referred to therein, and that copies be open to the inspection of all stockholders of the defendant companies. The said counter-proposal of the United States was as follows:

“Reading Company shall, with all due diligence, offer for sale at a reasonable price and upon reasonable terms the stock of the Central Railroad Company of New Jersey now owned by it for a period of years. If at the expiration of such period a sale of such stock has not been made, then, upon application of the Attorney General, the Court may decree a sale at public auction at a price not less than a minimum price to be agreed upon between the Reading Company and the Attorney General. During this period Reading Company shall accept any offer by a responsible purchaser made in good faith and at a reasonable price and in the event of any disagreement between an intending purchaser, who has complied with the foregoing provisions, and the Reading Company, then the matter shall be referred to the Attorney General for his advice and if the parties shall still be at a disagreement, then any party (Reading Company, the United States, or the intending purchaser) may bring the matter to the attention of the Court for its decision. A purchaser under this provision must be approved by the Attorney General, and, if a railroad company, shall apply to the Interstate Commerce Commission for its authority to make such purchase under paragraphs two and three of Section 407 of the Transportation Act of 1920.

“For the purpose of carrying out such a provision, jurisdiction of the case shall be retained by the Court.”

This cause came on for further hearing on March 1, 1921, and leave was given by this Court to all persons alleging interest herein to petition for leave to intervene. By permission of this Court the United States filed a

supplemental bill to make said Central Union Trust Company of New York, Trustee under said General Mortgage, a party defendant in this cause, and said Trust Company filed an answer thereto on March 18, 1921. Holders of General Mortgage bonds and of preferred and common stock of defendant Reading Company filed petitions for leave to intervene, and the Reading Company duly filed its answer to the petitions of intervening common stockholders and cross petition dated April 5, 1921.

By order entered herein on April 12, 1921, leave to intervene as parties defendant herein was granted to all who had petitioned for leave to intervene and Central Union Trust Company of New York was made a party herein.

By order entered herein on April 12, 1921, the Court directed that it would on May 2, 1921, hear argument upon the following questions:

"1. (a) Whether the sale provided for in paragraph five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of the Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

2. Whether the stock of the Coal Company should be sold free from the lien of the General Mortgage, or whether a sale of Certificates of Interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

3. Whether the Reading Company should offer a premium of ten per cent. to the General Mortgage bondholders for release of the Coal Company's prop-

erty from the lien of the mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause,"

and directed that all parties who desired to be heard should file briefs on April 30, 1921, containing in substance their proposed arguments.

This cause came on for further hearing on May 2, 1921, and the defendant Reading Company, with the approval of the Attorney General of the United States, submitted, in open court, modifications of the Plan, which met the objections of the bondholders and trustee under the General Mortgage, and all parties desiring to be heard were duly heard. Such modifications were thereafter reduced to writing by defendant Reading Company and the Attorney General of the United States and filed herein on May 12, 1921. The objection of the Attorney General of the United States to the provisions of paragraph 8 of the Plan (paragraph 7 of the Modified Plan), however, remained.

The Modified Plan, providing for the dissolution of the unlawful combination between Reading Company, Philadelphia and Reading Railway Company, (hereinafter called the Railway Company), The Philadelphia and Reading Coal and Iron Company (hereinafter called the Coal Company) and The Central Railroad Company of New Jersey (hereinafter called the Jersey Central), is as follows:

Modified Plan printed herein, *supra*, pp. 274 to 277, inclusive.

The plan for the disposition of the stock of The Lehigh & Wilkes-Barre Coal Company by the Jersey Central was submitted in a form to be embodied in a decree and is incorporated herein in section 8 hereof.

After consideration of the petitions, answer, briefs and oral arguments, the Court filed on May 21, 1921, its opinion in this cause.

IT IS ORDERED, ADJUDGED AND DECREED THAT:

1. The above recited Modified Plan is hereby approved as supplemented by the provisions of this decree.

2. The Reading Company, the Railway Company and the Coal Company shall consummate the provisions of the Modified Plan as so supplemented.

3. The Reading Company shall, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company, including the present right to vote and receive dividends thereon, to a new corporation to be formed with appropriate powers, and shall execute and deliver to Central Union Trust Company of New York, Trustee under the General Mortgage, and defendant Central Union Trust Company of New York shall honor (unless default shall be made and continue as provided in the General Mortgage), an irrevocable order directing it to execute and deliver to such new corporation suitable powers of attorney or proxies to vote such stock and orders for the payment of dividends thereon. Section 5 of the Modified Plan is supplemented as follows:

a. The names of the officers and directors of the new corporation to be elected and appointed in the first instance shall be submitted to the Court for its approval, and no officer or director of the new corporation shall be an officer or director of the Reading Company.

b. The Reading Company shall not sell, assign or transfer its right, title and interest in the stock of the Coal Company to the new corporation unless and until the new corporation shall enter its appearance herein by counsel and thereby submit itself to the jurisdiction of this Court for all purposes of this cause; and it shall thereupon become a party defendant in this cause and subject to the provisions of this decree. No dividends shall be declared or

paid on the stock of the Coal Company, prior to the sale, assignment and transfer by the Reading Company of its right, title and interest therein to the new corporation, except from current earnings subsequent to December 31, 1920.

c. The stock of the new corporation shall be issued to a Trustee or Trustees appointed by the Court. Such Trustee or Trustees shall issue certificates of interest therein as contemplated by the Modified Plan and as hereinafter provided. The Reading Company shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest. Neither the defendant Reading Company nor any corporation controlled by it nor any person acting in its interest shall acquire by purchase or otherwise any of said certificates of interest. Such certificates of interest shall be delivered to the subscribers therefor upon payment in full of the subscription price and compliance in all respects with the terms prescribed in the offer. All such certificates shall be registered by the Trustee or Trustees in the names of the purchasers. They shall be substantially in the form hereto annexed marked "Form A".

d. The Trustee or Trustees shall be entitled, and it shall be their duty, to vote or issue proxies for voting in respect of any and all of said shares of the new corporation held by the said Trustee or Trustees unless otherwise hereafter directed by this Court.

e. The Trustee or Trustees shall collect and receive any and all cash dividends paid on the stock of the new corporation held by the Trustee or Trustees. Upon the exchange, as hereinafter set forth, of any certificate of interest for shares of capital stock of the new corporation held by the Trustee or Trustees, the Trustee or Trustees shall pay in cash to the owner of the certificate of interest so exchanged or upon his order the amount of all cash dividends collected by the Trustee or Trustees, in respect of

the number of shares represented by such certificate of interest, but without interest thereon, and shall execute and deliver to such owner or upon his order a dividend order or assignment for the amount of any dividends declared but not then payable in respect of shares vested at the time of such exchange in the Trustee or Trustees as the registered stockholder entitled thereto. Any interest realized or allowed by the Trustee or Trustees upon funds paid to the Trustee or Trustees as dividends shall be applicable to the payment of the compensation of the Trustee or Trustees and the expenses of the administration of the trust, and any balance thereof remaining shall be paid to the defendant Reading Company unless otherwise ordered by the Court.

All dividends payable otherwise than in cash which shall be declared by the new corporation shall be received and held by the Trustee or Trustees for the *pro-rata* benefit of said registered owners, from time to time, of the certificates of interest, upon the same terms and conditions as the shares originally deposited, and shall be distributed to the persons who shall be the respective owners of the certificates of interest when and as, and only when and as, the shares originally deposited are distributed to them respectively, subject to any necessary adjustment by scrip or otherwise, in the discretion of the Trustee or Trustees, in respect of fractional shares.

No deduction shall be made by the Trustee or Trustees in the distribution of such dividends or subscription rights for any commissions or expenses of the Trustee or other costs of collection or payment.

f. Upon surrender of any outstanding certificates of interest by the registered owner thereof or his assignee, the Trustee or Trustees shall deliver to him stock certificates for the number of shares of the new corporation represented by the surrendered certificate of interest, which stock certificates shall be issued by the new corporation and registered on its books in the name of the new holder, upon condition, however, that the applicant for such exchange shall file with the Trustee a duly executed affidavit in one of the forms hereto annexed.

4. The provisions of Section 7 of the Modified Plan shall be consummated as follows:

a. The Reading Company shall transfer to a Trustee or Trustees to be appointed by this Court (hereinafter called the Jersey Central Trustee), subject to the lien of the Jersey Central Collateral Trust Mortgage dated April 1, 1901 (hereinafter called the Jersey Central Collateral Trust) from Reading Company to The Pennsylvania Company for Insurances on Lives and Granting Annuities, Trustee (hereinafter called the Pennsylvania Company), its right, title and interest in the stock of the Jersey Central.

b. The Jersey Central Trustee shall hold said right, title and interest in said shares of stock transferred to it as hereinabove provided, subject to the order of this Court. The final disposition of said stock shall be deferred in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, until ordered by this Court. The Court may in its discretion upon its own initiative or upon motion of the United States or the Reading Company without waiting such action by the Interstate Commerce Commission, enter an order for the sale of such stock, if and when it shall appear that the facts require it, or the situation makes it possible.

c. The Jersey Central Trustee shall be entitled, and it shall be its duty, to vote or cause to be voted all said shares of the Jersey Central unless otherwise hereafter directed by the Court. The Reading Company is hereby enjoined and restrained from voting upon any such shares of stock of the Jersey Central. The Reading Company shall from time to time direct the Pennsylvania Company, pursuant to the provisions of said Jersey Central Collateral Trust, to execute and deliver to the Jersey Central Trustee or its nominees suitable powers of attorney or proxies to vote upon such shares of stock.

d. Pending the entry of an order by this Court directing the final disposition of the Jersey Central stock, the Jersey Central Trustee is hereby enjoined

and restrained from exercising the voting power on the Jersey Central stock in such a way as to cause any dependence or intercorporate relations between the defendants Reading Company and the Jersey Central, and in particular from voting so that any officer or director of the Reading Company shall be elected an officer or director of the Jersey Central.

c. Pending the final disposition of the Jersey Central stock the Reading Company shall be entitled to receive all cash dividends on the stock of the Jersey Central. All dividends payable otherwise than in cash which shall be declared by the Jersey Central shall be received and held by the Jersey Central Trustee upon the same terms and conditions as the right, title and interest of Reading Company in the shares of stock in the Jersey Central originally transferred until finally disposed of as may be directed by order of this Court.

5. The defendants Reading Company, the Railway Company and the Coal Company shall proceed with due diligence to carry out the provisions of this decree and shall issue calls for meetings of their respective stockholders according to law for the purpose of submitting to the stockholders for their approval such action as may be appropriate to carry out the provisions of the Modified Plan as approved and supplemented by this decree or in connection therewith. As stockholder of the Railway Company and the Coal Company the Reading Company shall exercise its right to vote upon the stock of said companies, respectively, for the purpose aforesaid, and shall demand, and the defendant Central Union Trust Company of New York shall execute and deliver to it or its nominees, suitable powers of attorney or proxies for such purpose. Within six months from the date of this decree the defendants Reading Company, the Railway Company, and the Coal Company, shall report in writing to the Court what has been accomplished in carrying out the provisions of this decree.

6. If by reason of default on the General Mortgage bonds Central Union Trust Company of New York, the Trustee under the General Mortgage, shall exercise the right to vote the stock of the Coal Company, it shall so exercise that right as not to bring about unity of management between the Coal Company and the Reading Company; and in the event that said Trustee at any time is obliged to sell the stock or properties of the Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests.

7. The Coal Company is hereby permanently enjoined from issuing to the Reading Company, and the Reading Company is enjoined from receiving, any stock, bonds, or other evidences of corporate indebtedness of the Coal Company, in addition to the \$25,000,000 of four per cent. bonds provided for in paragraph 2 of the Modified Plan, except such evidences of current indebtedness as may be lawful between shipper and carrier.

8. The Central Railroad Company of New Jersey shall dispose of all the capital stock of The Lehigh & Wilkes-Barre Coal Company now owned by it to persons or corporations who are not its own stockholders or stockholders in either the Reading Company, the Railway Company or the Coal Company, and who previous to or at the time of purchase shall qualify as purchasers by a duly executed affidavit in one of the forms hereto annexed.

The affidavit in the case of an individual purchasing in his own right shall be substantially in the form hereto annexed marked "Form F".

If the purchaser is a corporation or a joint-stock company, the affidavit shall be executed by its president, vice-president, secretary or treasurer, or, in the case of a corporation of a foreign country, by one of its managing officers, and shall be substantially in the form hereto annexed marked "Form G".

If the purchaser is a partnership the affidavit shall be executed by one of the partners and shall be substantially in the form hereto annexed marked "Form H".

If the purchaser is an executor, administrator, guardian, or testamentary or other trustee of an express trust, the affidavit shall be executed by such executor, administrator, guardian or trustee as the case may be, or by one of such if the application is made on behalf of joint representatives, or, if such representative is a corporation or joint stock company, by its president, vice-president, secretary or treasurer, or, in the case of a corporation of a foreign country, by one of its managing officers, and shall be substantially in the form hereto annexed marked "Form I".

All of the said stock shall be disposed of within six months after the entry of this decree, or previous to any other later date which may be fixed by the Court. Stock may be disposed of in such manner and upon such terms as the Jersey Central may determine; provided, however, that it shall only be acquired by persons or corporations qualified to receive it under the terms of the said affidavits, and provided, further, not less than twenty per cent. shall be paid in cash at the time of its disposition by persons or corporations acquiring it.

On or before the date fixed by the Court before which the disposal of such stock shall be completed, the Jersey Central shall file or cause to be filed with the clerk of this Court a statement containing the names of the persons, corporations or partnerships to whom such stock has been disposed of and the number of shares acquired by each, to which statement shall be annexed the said affidavits.

Should all of the said stock not be disposed of before the expiration of six months after entry of this decree or previous to any later date which may be fixed by the Court, the remainder shall be then transferred to the Central Union Trust Company of New York (hereinafter

called the Wilkes-Barre Trustee) as the custodian and depository of the Court, subject to the provisions of this decree and to the further orders and decrees of the Court herein. Such stock shall be registered in the name of the Wilkes-Barre Trustee on the books of The Lehigh & Wilkes-Barre Coal Company and certificates therefor delivered to the Wilkes-Barre Trustee.

Such stock, together with any dividends received by the Wilkes-Barre Trustee thereon, shall be transferred by the Wilkes-Barre Trustee from time to time to persons to whom The Central Railroad Company of New Jersey may have sold the same and who are qualified to receive it under the terms of this decree.

Pending transfer the Wilkes-Barre Trustee shall receive such dividends declared on any stock standing in its name and may vote thereon at any stockholders' meeting.

The said Wilkes-Barre Trustee, having declared its submission to the jurisdiction of this Court for the purpose of carrying out this provision of this decree and having entered its appearance herein by counsel, is made a party hereto.

The Jersey Central shall from time to time, upon the request of the Attorney-General of the United States, furnish him with any information which he may require relating to the carrying out of this decree.

In order to enable the Jersey Central to dispose of the said stock of The Lehigh & Wilkes-Barre Coal Company to the greatest advantage without any accumulated dividends, the injunction heretofore granted in this suit is hereby modified so as to permit the Jersey Central to collect and receive any dividends which have been or may be declared upon the stock of The Lehigh & Wilkes-Barre Coal Company previous to disposition thereof.

9. All Trustees appointed by or pursuant to the foregoing provisions of this decree shall be entitled to reasonable compensation, the amount thereof to be approved by

the Court, for all services rendered by them as such Trustees. The compensation of the Trustees appointed pursuant to Sections 3 and 4 hereof, together with counsel fees, taxes and other expenses incurred hereunder and approved by the Court, shall be paid by the defendant Reading Company except so far as provided for under the provisions of paragraph *e* of Section 3 hereof. The compensation of the Trustee appointed by Section 8 hereof, together with counsel fees, taxes and other expenses incurred hereunder and approved by the Court, shall be paid by the Jersey Central.

Any Trustee or Trustees appointed by or pursuant to any provisions of this decree may at any time or from time to time appoint an agent or agents, and may delegate to any such agent or agents the performance of any administrative duties of such Trustee or Trustees.

10. Any individual or corporation appointed as trustee by or pursuant to this decree shall be subject to removal by this Court in its discretion, and, in the event of such removal, the Court shall appoint any other individual or corporation, as successor.

11. Any individual, or corporation, appointed as trustee by or pursuant to this decree, or any agent of any such trustee, shall be accountable for action hereunder only in proceedings in this cause and any order of this Court entered upon notice to such trustee, or such agent, to the Attorney-General of the United States and to the defendants, the Reading Company, the Railway Company, the Coal Company, the Jersey Central and The Lehigh & Wilkes-Barre Coal Company, and to the new corporation, shall be full protection for any action taken pursuant thereto.

12. Any such trustee or any of the parties to this cause mentioned in Section 11 may make application to

the Court at any time for such further orders and directions as may be necessary or proper in relation to the carrying out of the provisions of this decree, and jurisdiction of this cause is retained for the purpose of giving full effect to this decree and the decree entered herein on October 8, 1920, and for the purpose of making such other and further orders and decrees or taking such other action, if any, as may be necessary or appropriate to the carrying out and enforcement of said decrees and the directions of the Supreme Court.

June 6, 1921.

Per Curiam

JOS. BUFFINGTON,
J. WARREN DAVIS,
J. WHITAKER THOMPSON.

FORM A.

No. Shares.

CERTIFICATE OF INTEREST.

IN

COMPANY STOCK.

This is to certify that the undersigned (hereinafter designated as the "Trustee") has received and now holds for or assigns, certificates representing shares of the capital stock of the Company, a corporation of the State of , without par value, subject to the terms of a decree entered the day of June, 1921, by the District Court of the United States for the Eastern District of Pennsylvania, in the suit of the United States of America against Reading Company and others, to which de-

cree reference is hereby made for a statement of the terms and conditions upon which this certificate is issued and of the rights of the holder hereof, and to which decree the holder of this certificate assents by acceptance hereof.

This certificate is one of a series of certificates issued by the undersigned in accordance with the terms of said decree, representing in the aggregate not exceeding 1,400,000 shares of the capital stock of said

Company.

The registered owner hereof, or his assigns, is entitled, upon the surrender of this certificate and upon filing with the Trustee an affidavit in the form required by section 3f of said decree (to the effect, in substance, that the applicant does not own any shares of the capital stock of the Reading Company and is not acting for or on behalf of any stockholders of the Reading Company, or in concert, agreement or understanding with any other person, firm, or corporation for the control of the

Company in the interest of the Reading Company but in his own behalf in good faith) to receive a stock certificate for the number of shares of the capital stock of said

Company represented by this certificate and to receive the amount of all dividends (but without interest thereon) appertaining to the number of shares represented by this certificate collected and received by the Trustee prior to such exchange; also to receive a dividend order or assignment executed by the Trustee for any dividend declared but not then payable, appertaining to said shares which shall be vested, at the time of such conversion, in the Trustee as the registered holder of said shares.

This certificate is transferable by the registered owner hereof, in person or by his duly authorized attorney, at the office or agency of the Trustee in the City of New York upon surrender and cancellation hereof; and thereupon one or more new certificates for a like number of

shares will be issued to the transferee in exchange therefor.

This certificate is not valid until countersigned by the registrar.

IN WITNESS WHEREOF,
as Trustee, has caused this certificate to be executed
by
this day of , 1921.

Trustee.

By

Countersigned:

Registrar.

FORM OF ASSIGNMENT.

For value received the undersigned hereby sells, assigns, and transfers unto the interest in _____ Company shares and dividends thereon represented by the within certificate and does hereby irrevocably constitute and appoint _____ attorney to transfer the same on the books of the _____, Trustee, with full power of substitution in the premises.

Dated.....

In the presence of:

.....

.....

FORM B.

STATE OF....., County of, ss:

....., being duly sworn,
deposes and says:

That deponent is a *bona fide* owner in his (or her) proper right of a certificate or certificates of interest numbered for shares registered in the name of issued by as Trustee, under a decree entered on the day of June, 1921, by the District Court of the United States for the Eastern District of Pennsylvania, in the suit of the United States of America against Reading Company and others, and makes this affidavit for the purpose of procuring the issue of shares of the capital stock of the Company held by said Trustee, in exchange for said certificate (or certificates) of interest. That deponent does not own in his (or her) own right any shares of the capital stock of the Reading Company, a corporation of the Commonwealth of Pennsylvania, whether registered in his (or her) own name on the books of said Reading Company or registered in the names of others for deponent's use and benefit. That deponent, in making this application, is not acting for or on behalf of any stockholder of the Reading Company, or in concert, agreement, or understanding with any other person, firm or corporation for the control of the Company in the interest of the Reading Company, but in his (or her) own behalf in good faith.

Sworn to before me this)
day of , 1921. (

....., being duly sworn,
deposes and says:

shares, registered in the name of
issued by

Company held by said Trustee, in exchange for said certificate (or certificates) of interest. That said applicant does not own in its right any shares of the capital stock of the Reading Company, a corporation of the Commonwealth of Pennsylvania, whether registered in its own name on the books of said Reading Company or registered in the names of others for said applicant's use and benefit. That said applicant, in making this application, is not acting for or on behalf of any stockholder of the Reading Company, or in concert, agreement, or understanding with any other person, firm, or corporation for the control of the Company in the interest of the Read-

of the Company in the interest of the Reading Company, but in its own behalf in good faith.

Sworn to before me this }
day of , 1921. }

FORM D.

STATE OF....., County of....., ss:

....., being duly sworn,
deposes and says:

That he is a member of the partnership of
 , hereinafter called the "Applicants"; that
 said applicants are the *bona fide* owners in their own
 proper right of a certificate or certificates of interest
 numbered for shares, registered in
 the name of , issued by
 as Trustee, under a decree entered on
 the day of June, 1921, by the District Court of
 the United States for the Eastern District of Pennsyl-
 vania, in the suit of the United States of America against
 Reading Company and others, and deponent makes this
 affidavit for the purpose of procuring the issue of shares
 of the capital stock of the
 Company held by said Trustee in exchange for said cer-
 tificate (or certificates) of interest. That said applicants
 do not own in their own right any shares of the capital
 stock of the Reading Company, a corporation of the Com-
 monwealth of Pennsylvania, whether registered in the ap-
 plicants' own name on the books of said Reading Com-
 pany or registered in the names of others for their use
 and benefit. That said applicants, in making this applica-
 tion, are not acting for or on behalf of any stockholder
 of the Reading Company, or in concert, agreement, or
 understanding with any other person, firm, or corporation
 for the control of the Company in the inter-
 est of the Reading Company, but in their own behalf in
 good faith.

Sworn to before me this }
 day of , 1921. }

FORM E.

STATE OF, County of, ss:

....., being duly sworn,
deposes and says:

That is he of ;
that the trust estate represented by deponent is the
bona fide owner in its proper right of a certificate or
certificates of interest numbered for
shares, registered in the name of
issued by , as Trustee,
under a decree entered on the day of June,
1921, by the District Court of the United States for
the Eastern District of Pennsylvania, in the suit of
the United States of America against Reading Com-
pany and others. That deponent makes this affidavit
for the purpose of procuring the issue of shares of the
capital stock of Company
held by said Trustee, in exchange for said certificate
(or certificates) of interest. That said trust estate
does not own any shares of the capital stock of the
Reading Company, a corporation of the Common-
wealth of Pennsylvania, whether registered in the name
of said trust estate on the books of said Reading Com-
pany or registered in the names of others for the use
and benefit of said trust estate. That said trust estate,
in making this application, is not acting for or on be-
half of any stockholder of the Reading Company, or
in concert, agreement, or understanding with any other
person, firm, or corporation for the control of the
Company in the interest of
the Reading Company, but in its own behalf in good
faith.

Sworn to before me this }
day of , 1921. }

FORM F.

STATE OF, County of, ss:

....., being duly sworn, deposes and says: That deponent is the *bona fide* purchaser in his (or her) own proper right of a certificate or certificates for shares of the capital stock of The Lehigh & Wilkes-Barre Coal Company, transferred to him (or her) by The Central Railroad Company of New Jersey under a decree entered on the day of, 1921, in the suit of The United States of America *vs.* Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey, The Lehigh & Wilkes-Barre Coal Company, *et al.*, and makes this affidavit at or previous to the time of the issuance to him (or her) of such certificate or certificates for the purpose of evidencing his (or her) right to receive the same. That deponent does not own in his (or her) own right any shares of the capital stock of The Central Railroad Company of New Jersey, Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, whether registered in his (or her) own name on the books of said companies or any of them or registered in the names of others for deponent's use and benefit. That deponent in receiving the said certificate or certificates is not acting for or on behalf of any stockholder of The Central Railroad Company of New Jersey or of any other of the said companies or in concert, agreement or understanding with any other person, firm or corporation for the control of The Lehigh & Wilkes-Barre Coal Company in the interest of The Central Railroad Company of New Jersey or of any other of the said companies, but is acting in his (or her) own behalf in good faith.

Sworn to before me this }
 day of , 1921. }

FORM G.

STATE OF, County of, ss:

....., being duly sworn, deposes and says: That he is of
, a corporation (or a joint stock company). That said corporation is the *bona fide* purchaser in its own proper right of a certificate or certificates for shares of the capital stock of The Lehigh & Wilkes-Barre Coal Company, transferred to it by The Central Railroad Company of New Jersey under a decree entered on the day of, 1921, in the suit of The United States of America *vs.* Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey, The Lehigh & Wilkes-Barre Coal Company *et al.*, and makes this affidavit at or previous to the time of the issuance to it of such certificate or certificates for the purpose of evidencing its right to receive the same. That said corporation does not own in its own right any shares of the capital stock of The Central Railroad Company of New Jersey, Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, whether registered in its own name on the books of said companies or any of them or registered in the names of others for its use and benefit. That said corporation in receiving the said certificate or certificates is not acting for or on behalf of any stockholder of The Central Railroad Company of New Jersey or of any other of the said companies or in concert, agreement or understanding with any other person, firm or corporation for the control of The Lehigh & Wilkes-Barre Coal Company in the interest of The Central Railroad Company of New Jersey or of any other of the said companies, but is acting in its own behalf in good faith.

Sworn to before me this }
 day of , 1921.}

FORM H.

STATE OF, County of, ss:

....., being duly sworn, deposes and says: That he is a member of the partnership of (hereinafter called the "Partnership"). That said partnership are the *bona fide* purchasers in their own proper right of a certificate or certificates for shares of the capital stock of The Lehigh & Wilkes-Barre Coal Company, transferred to them by The Central Railroad Company of New Jersey under a decree entered on the day of, 1921, in the suit of The United States of America *vs.* Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey, The Lehigh & Wilkes-Barre Coal Company, *et al.*, and makes this affidavit at or previous to the time of the issuance to them of such certificate or certificates for the purpose of evidencing their right to receive the same. That said partnership does not own in their own right any shares of the capital stock of The Central Railroad Company of New Jersey, Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, whether registered in their own name on the books of said companies or any of them or registered in the names of others for their use and benefit. That said partnership in receiving the said certificate or certificates is not acting for or on behalf of any stockholder of The Central Railroad Company of New Jersey or of any other of the said companies or in concert, agreement or understanding with any other person, firm or corporation for the control of The Lehigh & Wilkes-Barre Coal Company in the interest of The Central Railroad Company of New Jersey or of any other of the said companies, but is acting in their own behalf in good faith.

Sworn to before me this }
day of , 1921. }

FORM I.

STATE OF, County of, ss:

....., being duly sworn,
deposes and says: That he is of ;
that the trust estate represented by deponent is the *bona fide* purchaser in its own proper right of a certificate or certificates for shares of the capital stock of The Lehigh & Wilkes-Barre Coal Company transferred to him by the Central Railroad of New Jersey under a decree entered on the day of June, 1921, in the suit of the United States of America *vs.* Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company, The Central Railroad Company of New Jersey, The Lehigh & Wilkes-Barre Coal Company, *et al.*, and makes this affidavit at or previous to the time of the issuance to him of such certificate or certificates for the purpose of evidencing his right to receive the same. That said trust estate does not own any shares of the capital stock of The Central Railroad Company of New Jersey, the Reading Company, Philadelphia & Reading Railway Company, The Philadelphia & Reading Coal & Iron Company whether registered in the name of said trust estate on the books of said companies or any of them or registered in the names of others for the use and benefit of said trust estate. That said trust estate in receiving the said certificate or certificates is not acting for or on behalf of any stockholder of The Central Railroad of New Jersey or of any other of the said companies, or in concert, agreement, or understanding with any other person, firm, or corporation for the control of The Lehigh & Wilkes-Barre Coal Company in the interest of The Central Railroad of New Jersey or of any other of the said companies but is acting in its own behalf in good faith.

Sworn to before me this }
day of , 1921. }

Order Appointing Trustees.

(Filed June 11, 1921.)

A decree having been entered in the above-entitled cause on June 6, 1921, providing, in section 3, for the appointment of certain trustees, known as Coal Company Trustees, to hold the stock of the new company to be organized as in said section provided, and further providing, in section 4, for the appointment of certain trustees, known as Jersey Central Trustees, to hold Reading Company's equity in the stock of The Central Railroad Company of New Jersey,

Now, therefore, the Court being fully advised in the premises by this order doth appoint as Coal Company Trustees Newton H. Fairbanks, of Springfield, Ohio, and Joseph B. McCall, of Philadelphia, Pennsylvania, and doth appoint as Jersey Central Trustees, R. E. McCarty, of Pittsburgh, Pennsylvania, and C. S. W. Packard, of Philadelphia, Pennsylvania.

The two groups of trustees thus appointed shall proceed diligently to perform the duties conferred upon them, respectively, by the provisions of the aforesaid decree of June 6, 1921. In case the members of either group shall disagree in the exercise of the voting power of stock committed to their charge, or in respect of any matter within the scope of their duties, they, or either of them, may apply to the Court for its direction.

Dated June 11, 1921.

Per Curiam,

JOS. BUFFINGTON,
J. WARREN DAVIS,
J. WHITAKER THOMPSON.

**Petition of Continental Insurance Company and Fidelity-Phenix
Fire Insurance Company for Appeal.**

(Filed June 16, 1921.)

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, having intervened herein as parties defendant pursuant to the order of this Honorable Court made and entered on April 12, 1921, granting them leave so to do, and conceiving themselves aggrieved by the Final Decree entered in the above entitled and numbered cause on June 6, 1921, present this petition by their counsel and pray an appeal from said Final Decree to the Supreme Court of the United States.

The particulars wherein and the reasons wherefor your petitioners conceive the said decree erroneous are set forth in the assignments of error filed herewith, to which reference is made.

Your petitioners further pray that an order be made by this Honorable Court fixing the amount of the security which they shall furnish upon such appeal, including security for all damages and costs in the event that they shall fail to make their plea good, and that upon giving such security so much of the aforesaid decree as is contained in the paragraphs thereof hereinafter set forth, be superseded and all action and proceedings thereunder or with respect thereto stayed until the determination of such appeal by the Supreme Court of the United States, to wit:

(a) Paragraph 1 of said decree insofar as it approves that part of Section 5 of the Modified Plan which provides with respect to the issue by the new corporation of 1,400,000 shares of stock without par value, that—

“Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000 at \$2 for each share of Reading stock”

as supplemented by that part of subdivision (c) of paragraph 3 of said decree which provides that—

“Such Trustee or Trustees shall issue certificates of interest therein” (stock of the new corporation) “as contemplated by the Modified Plan and as hereinafter provided. The Reading Company shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest.”

(b) Paragraph 2 of said decree insofar as it directs that the Reading Company shall consummate those of the provisions of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree as hereinabove set forth.

(c) That part of subdivision (c) of paragraph 3 of said decree which provides that—

“The Trustee or Trustees shall issue certificates of interest therein” (stock of the new corporation) “as contemplated by the Modified Plan and as hereinafter provided. The Reading Company shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest.”

(d) That part of paragraph 5 of said decree which provides that—

“The Reading Company * * * shall proceed with due diligence to carry out the provisions of this decree and shall issue calls for meetings of * * * stockholders according to law for the purpose of submitting to the stockholders for their approval such action as may be appropriate to carry out the provisions of the Modified Plan as approved and supplemented by this decree or in connection therewith.”

insofar as the same applies to any meetings of, action or approval by, stockholders of the Reading Company or others with respect to that part of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree as in paragraph (a) hereof set forth.

(e) All other parts of said decree which approve or direct the distribution to or subscription by stockholders of the Reading Company, preferred and common, share and share alike, of shares of stock or certificates of interest therein, issued or to be issued with respect to the right, title and interest of the Reading Company in and to the stock of the Philadelphia & Reading Coal & Iron Company, or which approve or direct action with respect to such distribution or subscription.

And your petitioners further respectfully represent that if the parts of the decree hereinbefore set forth stand in full force and effect until such appeal is heard, your petitioners will suffer great and irreparable injury as more fully appears from the record in this cause, and your petitioners pray that this Honorable Court order that said appeal and said bond shall supersede, stay and suspend the operation and effect of said parts of said decree.

Your petitioners further pray that a transcript of the record, proceedings and papers on which said decree was made and entered, duly authenticated, may be transmitted forthwith to the Supreme Court of the United States.

Dated, June 15, 1921.

ALFRED A. COOK,
Solicitor and Counsel for Continental
Insurance Company and Fidelity-
Phenix Fire Insurance Company of
New York.

Assignments of Error.

(Filed June 16, 1921.)

COME NOW Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, two of the intervening defendants herein, and show by their counsel that in the record and proceedings in the above entitled cause manifest error has occurred to the prejudice of them and assign the following errors upon which they rely for a reversal of the Final Decree entered herein on June 6, 1921, in the particulars wherein error is assigned, to wit:

1. The Court erred in approving that part of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree which provides for the distribution to or subscription by stockholders of the Reading Company, preferred and common, share and share alike, upon the payment of \$2 per share for each share of stock of the Reading Company held by them, of shares of stock, or certificates of interest therein, issued or to be issued with respect to the right, title and interest of the Reading Company in and to the stock of the Philadelphia & Reading Coal & Iron Company in said decree and hereinafter called the Coal Company.

2. The Court erred in directing the consummation of that part of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree which provides for the distribution to or subscription by stockholders of the Reading Company, preferred and common, share and share alike, upon the payment of \$2. per share for each share of stock of the Reading Company held by them, of shares of stock, or certificates of interest therein, issued with respect to the right, title and interest of the Reading Company in and to the stock of the Coal Company.

3. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company, as set forth in Section 5 of the Modified Plan as supplemented by said decree, does not confer upon the holders of the preferred stock of the Reading Company a benefit to the prejudice of the rights of the holders of the common stock of the Reading Company.

4. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in Section 5 of the Modified Plan as supplemented by said decree is a sale to the stockholders of the Reading Company of its right, title and interest in and to the stock of the Coal Company.

5. The Court erred in holding that the sum of \$2. per share to be paid with respect to each share of stock of the Reading Company, to wit, the aggregate sum of \$5,600,000., is an adequate consideration for the disposition by the Reading Company of its right, title and interest in and to the stock of the Coal Company.

6. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company was a distribution of capital of the Reading Company.

7. The Court erred in not holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree, effectuates a distribution in part at least of or from the surplus or earnings of the Reading Company.

8. The Court erred in holding that it was warranted in treating the holders of common stock of the Reading Company who had not appeared and objected to the Plan as proposed, as acquiescing therein.

9. The Court erred in holding that it was justified in concluding from the positive attitude of a holder of 100,000 shares of common stock of the Reading Company that the holders of the remaining common stock who did not appear, had not only passively acquiesced in, but really actively approved of the Plan as proposed.

10. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in Section 5 of the Modified Plan as supplemented by said decree, was a violation of the rights of the holders of the common stock.

11. The Court erred in that it did not hold that the holders of the common stock are solely entitled to distribution out of surplus of the Reading Company earned in years other than those in which the first preferred and second preferred stock were not paid full dividends.

12. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by said decree, is not a sale of the right, title and interest of the Reading Company in and to said stock.

13. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in Section 5 of the Modified Plan as supplemented by said decree, was a distribution to stockholders in part at least of or from the surplus or earnings of the Reading Company.

14. The Court erred in that it did not hold that the holders of the preferred stock of the Reading Company are limited to dividends not exceeding 4% per annum and no more.

15. The Court erred in that it did not hold that the Modified Plan as supplemented by said decree, did not effectuate a dissolution or liquidation of the Reading Company.

WHEREFORE Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York pray that the Final Decree entered herein on June 6, 1921, be reversed in the particulars wherein error is assigned.

Dated, June 15, 1921.

ALFRED A. COOK,
Solicitor for Continental Insurance
Company and Fidelity-Phenix Fire
Insurance Company of New York,
Office and Post-Office Address,
Trinity Building,
New York City, N. Y.

Order Allowing Appeal.

(Filed June 16, 1921.)

BE IT REMEMBERED that in the above entitled and numbered cause, on this June 16, 1921, the petitioners, Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, intervening defendants in said cause, appearing by their counsel, presented and caused to be filed their petition praying an appeal to the Supreme Court of the United States from the Final Decree entered herein on June 6, 1921, and at the same time presented and caused to be filed their

assignments of error, all as required by the Statutes and Rules of Court.

On consideration thereof the Court ORDERS AND DECREES that the appeal be allowed as prayed, and the Clerk is directed to transmit forthwith to the Supreme Court of the United States a properly authenticated transcript of the record, papers and proceedings.

IT IS FURTHER ORDERED AND DECREED that a bond for all damages and costs in the event that they shall fail to make their plea good shall be executed by said appellants and the amount of the same is hereby fixed at \$750,000. and upon entry of said bond with a surety satisfactory to the Court, so much of the aforesaid Final Decree entered herein on June 6, 1921, as is contained in the paragraphs thereof hereinafter set forth, be superseded, and all action and proceedings thereunder or with respect thereto stayed until the final determination of said appeal by the Supreme Court of the United States, to wit:

(a) Paragraph 1 of said decree insofar as it approves that part of Section 5 of the Modified Plan which provides with respect to the issue by the new corporation of 1,400,000 shares of stock without par value, that—

“Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000. at \$2. for each share of Reading stock”.

as supplemented by that part of subdivision (c) of paragraph 3 of said decree which provides that—

“Such Trustee or Trustees shall issue certificates of interest therein” (stock of the new corporation) “as contemplated by the Modified Plan and as hereinafter provided. The Reading Company shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest.”

(b) Paragraph 2 of said decree insofar as it directs that the Reading Company shall consummate those of the provisions of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree as hereinabove set forth.

(c) That part of subdivision (c) of paragraph 3 of said decree which provides that—

“The Trustee or Trustees shall issue certificates of interest therein” (stock of the new corporation) “as contemplated by the Modified Plan and as hereinafter provided. The Reading Company shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest.”

(d) That part of paragraph 5 of said decree which provides that—

“The Reading Company * * * shall proceed with due diligence to carry out the provisions of this decree and shall issue calls for meetings of * * * stockholders according to law for the purpose of submitting to the stockholders for their approval such action as may be appropriate to carry out the provisions of the Modified Plan as approved and supplemented by this decree or in connection therewith”,

insofar as the same applies to any meetings of, action or approval by, stockholders of the Reading Company or others with respect to that part of Section 5 of the Modified Plan as supplemented by subdivision (c) of paragraph 3 of said decree as in paragraph (a) hereof set forth.

(e) All other parts of said decree which approve or direct the distribution to or subscription by stockholders of the Reading Company, preferred and common, share and share alike, of shares of stock or certificates of interest therein, issued or to be issued with respect to the

right, title and interest of the Reading Company in and to the stock of the Philadelphia & Reading Coal & Iron Company, or which approve or direct action with respect to such distribution or subscription.

J. W. THOMPSON

D. J.

Supersedeas Bond and Bond on Appeal.

(Filed July 22, 1921.)

KNOW ALL MEN BY THESE PRESENTS, That we, CONTINENTAL INSURANCE COMPANY, a corporation organized and existing under the laws of the State of New York, and FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK, likewise a corporation organized and existing under the laws of the State of New York, as principals, and UNITED STATES FIDELITY & GUARANTY COMPANY, a corporation organized and existing under the laws of the State of Maryland, as surety, are held and firmly bound unto

THE UNITED STATES OF AMERICA,

READING COMPANY,

THE PHILADELPHIA & READING COAL AND IRON
COMPANY,

PHILADELPHIA & READING RAILWAY COMPANY,

THE CENTRAL RAILROAD OF NEW JERSEY,

LEHIGH & WILKES-BARRE COAL COMPANY,

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN

H. MASON, as a Committee representing holders
of Common stock of the Reading Company;

ADRIAN ISELIN, ROBERT B. DODSON and WILLIAM A.

LAW, as a Committee representing holders of
Preferred stock of the Reading Company;

THE NEW YORK CENTRAL RAILROAD COMPANY;

THE BALTIMORE & OHIO RAILROAD COMPANY;

WILLIAM B. KURTZ and MADGE FULTON KURTZ;

PENN MUTUAL LIFE INSURANCE COMPANY;
 THE PENNSYLVANIA COMPANY FOR INSURANCE ON
 LIVES AND GRANTING ANNUITIES;
 FRANCES T. INGRAHAM, ROBERT S. INGRAHAM, MABEL
 S. INGRAHAM and MARCUS L. TAFT;
 THE GIRARD AVENUE TITLE AND TRUST COMPANY;
 JOSEPH E. WIDENER;
 CENTRAL UNION TRUST COMPANY OF NEW YORK as
 Trustee under the General Mortgage made by
 the Reading Company and the Philadelphia &
 Reading Coal and Iron Company, dated January
 5, 1897;

in the full and just sum of \$750,000, to be paid unto the
 aforesaid persons, committees and corporations, their suc-
 cessors, executors, administrators and assigns; to which
 payment well and truly to be made, we bind ourselves, our
 successors and assigns jointly and severally by these
 presents. Sealed with our seals and dated this July 19,
 1921.

WHEREAS lately at a session of the District Court of
 the United States within and for the Eastern District of
 Pennsylvania, in a suit pending in said Court in Equity,
 No. 1095, between The United States of America against
 Reading Company and others, either originally parties de-
 fendant in said suit or subsequently made parties defend-
 ant by orders of said Court, a final decree was rendered
 and entered in the office of the Clerk of said Court on
 June 6, 1921, and Continental Insurance Company and
 Fidelity-Phenix Fire Insurance Company of New York
 having obtained an order allowing an appeal from said
 final decree and filed a copy thereof in the office of the
 Clerk of said Court on June 16, 1921, and a citation
 directed to the parties to the aforesaid suit citing and
 admonishing them to be and appear at a session of the
 Supreme Court of the United States to be holden in the
 City of Washington, in the District of Columbia within
 thirty days,

NOW THE CONDITION OF THE ABOVE OBLIGATION IS SUCH that if Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York prosecute their appeal to effect and answer all damages and costs if they fail to make their plea good, then the above obligation to be void; else to remain in full force and virtue.

Sealed and Delivered in }
the Presence of: }

ERNEST STURM
CHAS. E. SWAN

CONTINENTAL INSURANCE COMPANY,
By J. E. LOPEZ,
President.

Attest:

ERNEST STURM,
Secretary.

FIDELITY-PHENIX FIRE INSURANCE COMPANY
OF NEW YORK,
By C. R. STREET,
President.

Attest:

ERNEST STURM,
Secretary.

UNITED STATES FIDELITY & GUARANTY COMPANY,
By WALTER ZEBLEY,
Vice-President.

Attest:

R. S. REIM,
Resident Secretary.

[SEAL]

Before THOMPSON, J.

Approved by
By the Court.

Attest:

LEO A. LILLY, Deputy Clerk.

STATE OF NEW YORK }
 County of New York } ss:

On July 19, 1921 before me came J. E. LOPEZ, to me known, who, being by me duly sworn, did depose and say that he resides in New York, N. Y., that he is the President of the Continental Insurance Company, the corporation described in, and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

CHAS. E. SWAN,

[SEAL] Notary Public Kings County New York No
 890 Certificate filed in New York County N.
 Y. No. 65, Kings Co. Reg. No. 3050 New York
 Co. Reg. No. 3110

STATE OF NEW YORK }
 County of New York } ss:

On July 19, 1921, before me came C. R. STREET, to me known, who, being by me duly sworn, did depose and say that he resides in New York, N. Y., that he is the President of the Fidelity-Phenix Fire Insurance Company of New York, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation; and that he signed his name thereto by like order.

CHAS. E. SWAN,

[SEAL] Notary Public Kings County New York No
 890 Certificate filed in New York N. Y. No
 65, Kings Co. Reg. No. 3050 New York Co.
 Reg. No. 3110

Citation.

UNITED STATES OF AMERICA, ss.

THE PRESIDENT OF THE UNITED STATES,

To

THE UNITED STATES OF AMERICA

READING COMPANY

THE PHILADELPHIA & READING COAL AND IRON COMPANY

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY

LEHIGH & WILKES-BARRE COAL COMPANY

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN
H. MASON, as a Committee representing holders
of Common Stock of the Reading Company

ADRIAN ISELIN, ROBERT B. DODSON and WILLIAM A.
LAW as a Committee representing holders of
Preferred Stock of the Reading Company

THE NEW YORK CENTRAL RAILROAD COMPANY

THE BALTIMORE & OHIO RAILROAD COMPANY

WILLIAM B. KURTZ and MADGE FULTON KURTZ

PENN MUTUAL LIFE INSURANCE COMPANY

THE PENNSYLVANIA COMPANY FOR INSURANCE ON
LIVES AND GRANTING ANNUITIES

FRANCES T. INGRAHAM, ROBERT S. INGRAHAM, MABEL
S. INGRAHAM and MARCUS L. TAFT

THE GIRARD AVENUE TITLE AND TRUST COMPANY

JOSEPH E. WIDENER

CENTRAL UNION TRUST COMPANY OF NEW YORK as
Trustee under the General Mortgage made by
the Reading Company and the Philadelphia &
Reading Coal and Iron Company, dated January
5, 1897

PHILADELPHIA & READING RAILWAY COMPANY

GREETING:

You are hereby cited and admonished to be and appear at a session of the Supreme Court of the United

States to be holden in the City of Washington, in the District of Columbia within thirty days, pursuant to an appeal filed in the Clerk's Office of the District Court of the United States, Eastern District of Pennsylvania, wherein Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York are Appellants and you are Appellees, to show cause, if any there be, why the decree rendered against the said Appellants as in said appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

WITNESS the Honorable J. WHITAKER THOMPSON,
Judge of the District Court of the United States this 21st
day of July, 1921.

J. W. THOMPSON
District Judge.

Service of the within citation is admitted on the date
set opposite our respective names:

August 4, 1921

GUY D. GOFF
United States Acting Attorney General

August 3, 1921

CHAS. HEEBNER
Attorney for Reading Company

August 3, 1921

CHAS. HEEBNER
Attorney for Philadelphia & Reading
Coal & Iron Co.

August 6th, 1921

ROBERT W. DE FOREST
CHARLES E. MILLER
Attorneys for The Central Railroad
Company of New Jersey

August 6th, 1921

ROBERT W. DE FOREST
CHARLES E. MILLER
Attorneys for Lehigh & Wilkes-Barre
Coal Co.

August 1st, 1921

WHITE & CASE
Attorneys for Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee representing holders of Common Stock of Reading Company

August 1st, 1921

CADWALADER, WICKERSHAM & TAFT
Attorneys for Adrian Iselin, Robert B. Dodson and William A. Law, as a Committee representing holders of Preferred Stock of Reading Company

August 1st, 1921

ALEXANDER S. LYMAN
Attorney for The New York Central Railroad Company

August 3, 1921

H. B. GILL
HUGH L. BOND
Attorneys for The Baltimore & Ohio Railroad Company

August 3, 1921

T. R. WHITE
Attorney for William B. Kurtz and Madge Falton Kurtz

August 2nd, 1921

GEORGE WHARTON PEPPER
by J. N. Conwell
Attorney for Penn Mutual Life Insurance Company

**Further Order enlarging time to docket Case and file Transcript,
filed October 19, 1921.**

On reading and filing the annexed affidavit verified October 14, 1921, praying for the enlargement of the time of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, appellants, to docket the case in the Supreme Court of the United States and file the record thereof with the Clerk of said Court,

ORDERED that the time of Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, appellants, to docket the case in the Supreme Court of the United States and to file the record thereof with the Clerk of said Court, be and it hereby is enlarged to and including November 15, 1921.

J. W. THOMPSON

United States District Judge.

Dated, October 14, 1921.

Petition of Seward Prosser, et al., for Appeal.

(Filed Aug. 3, 1921.)

Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee formed at the request of certain holders of common stock of defendant Reading Company, having intervened in the above-entitled cause as parties defendant pursuant to leave given by an order of this Court entered on the 12th day of April, A. D., 1921, and feeling themselves aggrieved by the final decree of this Court entered in the above-entitled cause on the 6th day of June, 1921, now come, by J. DuPratt White, their counsel, and pray that an appeal may be allowed to them from the said final decree to Supreme Court of the United States and, in connection with this petition, present herewith their assignment of errors.

Petitioners further pray that citation be issued as provided by law and that a transcript of the record, proceedings and papers upon which said decree was based, duly authenticated, be transmitted to the Supreme Court of the United States under the rules of said Court in such cases made and provided.

Petitioners further pray that the proper order be made relating to the security for costs to be required of them.

Dated, New York, N. Y., August 1, 1921.

J. DUPRATT WHITE,
Counsel for Intervening Defendants
Seward Prosser, Mortimer N. Buckner
and John H. Mason, as a Committee as
aforesaid.

Assignment of Errors.

(Filed Aug. 3, 1921.)

Now come Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee formed at the request of certain holders of common stock of defendant Reading Company, intervening parties defendant in the above-entitled cause, by J. DuPratt White, their counsel, and, in connection with their petition for appeal, show that in the record and proceedings in the above-entitled cause, and in the final decree of this Court entered herein on the 6th day of June, 1921, manifest error has intervened to their prejudice and file the following assignment of errors upon which they will rely upon the prosecution of their appeal from said final decree, to wit:

1. The Court erred in approving that part of paragraph 5 of the Modified Plan as supplemented by the provisions of sub-paragraph (c) of paragraph 3 of said decree which provides that the Reading Company shall

offer for subscription to its stockholders, preferred and common, share and share alike, at \$2. for each share of Reading stock, assignable certificates of interest in the stock of the new corporation to which the Reading Company shall, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of Philadelphia & Reading Coal & Iron Company (hereinafter called the "Coal Company").

2. The Court erred in ordering the consummation of the provisions of that part of paragraph 5 of the Modified Plan as supplemented by the provisions of sub-paragraph (c) of paragraph 3 of said decree which provides that the Reading Company shall offer for subscription to its stockholders, preferred and common, share and share alike, at \$2 for each share of Reading stock, assignable certificates of interest in the stock of the new corporation to which the Reading Company shall, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company.

3. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company provided for in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree does not confer upon the holders of the preferred stock of the Reading Company a benefit to the prejudice of the legal rights of the holders of the common stock of the Reading Company.

4. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a sale to the stockholders of the Reading Company of such right, title and interest.

5. The Court erred in holding that the sum of \$5,600,000, or \$2.00 for each share of stock of the Reading Company, is an adequate consideration for the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company.

6. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a disposition of a part of the capital of the Reading Company.

7. The Court erred in not holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree effectuates a distribution in part at least of or from the surplus net profits of the Reading Company.

8. The Court erred in holding that it was warranted in treating as acquiescing in the Modified Plan the holders of common stock of the Reading Company who had failed to object thereto.

9. The Court erred in holding that it was justified in concluding from the positive attitude of a holder of 100,000 shares of common stock of the Reading Company that the remainder of the holders of such stock who failed to object to the modified Plan were not only passively acquiescing in, but really actively approving, the same.

10. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company pro-

vided in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is in violation of the legal rights of the holders of the common stock of the Reading Company.

11. The Court erred in that it did not hold that the holders of the common stock are solely entitled to distributions out of surplus net profits of the Reading Company of years other than those in which the full dividends shall not have been paid on the first and second preferred stock.

12. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is not a sale of such right, title and interest.

13. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a distribution in part at least of or from the surplus net profits of the Reading Company.

14. The Court erred in that it did not hold that the holders of the preferred stock of the Reading Company are entitled to non-cumulative dividends not exceeding 4% per annum and no more.

15. The Court erred in that it did not hold that the Modified Plan as supplemented by the provisions of said decree does not effectuate a dissolution or liquidation of the Reading Company.

16. The Court erred in holding that the right of the stockholders of the Reading Company to participate in the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company is based on the corporate right of all shareholders in a Pennsylvania Corporation to share equally on a disposition of its assets.

17. The Court erred in not holding that the rights of the stockholders of the Reading Company to participate in the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company are determined by the contractual rights existing between the Reading Company and its stockholders and among said stockholders, which contractual rights are expressed in the certificates of the first preferred, second preferred and common stocks of the Reading Company.

WHEREFORE Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee as aforesaid, pray that the final decree of this Court entered herein on the 6th day of June, 1921, be reversed in the particulars wherein error is assigned.

Dated, New York, N. Y., August 1, 1921.

J. DUPRATT WHITE,
Counsel for Seward Prosser,
Mortimer N. Buckner and John
H. Mason, as a Committee as
aforesaid.

Order Allowing Appeal.**(Filed August 3, 1921.)**

On this 2nd day of August, 1921, Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee formed at the request of certain holders of common stock of defendant Reading Company, intervening parties defendant in the above-entitled cause, appearing by their counsel, presented and caused to be filed their petition praying that an appeal may be allowed to them from the final decree entered herein on the 6th day of June, 1921, to the Supreme Court of the United States, and presented and caused to be filed with said petition their assignment of errors, pursuant to the statutes and rules of Court in such cases made and provided.

On consideration thereof it is ORDERED that an appeal be, and the same hereby is, allowed as prayed.

IT IS FURTHER ORDERED that citation be issued as provided by law and that a transcript of the record, proceedings and papers upon which said decree was based, duly authenticated, be transmitted to the Supreme Court of the United States under the rules of said Court in such cases made and provided.

IT IS FURTHER ORDERED that the security for costs on appeal be fixed at the sum of \$2,500.00/100.

Dated, Philadelphia, Pa., August 2nd, 1921.

J. W. THOMPSON

United States District Judge.

Receipt of Security for Costs.

Received of Seward Prosser, Mortimer N. Buckner and John H. Mason, as a Committee formed at the request of certain holders of common stock of Reading Company, intervening parties defendant herein, the sum of Two Thousand Five Hundred Dollars (\$2,500.00) as

security for costs on appeal given pursuant to an order allowing appeal signed by Hon. J. W. Thompson, one of the Judges of this Court, on August 2, 1921.

Philadelphia, August 5, 1921.

GEORGE BRODBECK

Clerk of the aforesaid Court.

Citation.

UNITED STATES OF AMERICA, ss.

THE PRESIDENT OF THE UNITED STATES,

To

THE UNITED STATES OF AMERICA,
READING COMPANY,

THE PHILADELPHIA & READING COAL & IRON COM-
PANY,

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
LEHIGH & WILKES-BARRE COAL COMPANY,
CONTINENTAL INSURANCE COMPANY,
FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW
YORK,

ADRIAN ISELIN, ROBERT B. DODSON, and WILLIAM
A. LAW, as a Committee representing holders of
Preferred Stock of the Reading Company,

THE NEW YORK CENTRAL RAILROAD COMPANY,
THE BALTIMORE & OHIO RAILROAD COMPANY,
WILLIAM B. KURTZ and MADGE FULTON KURTZ,
PENN MUTUAL LIFE INSURANCE COMPANY,
THE PENNSYLVANIA COMPANY FOR INSURANCE ON
LIVES AND GRANTING ANNUITIES,

FRANCES T. INGRAHAM, ROBERT S. INGRAHAM, MABEL
S. INGRAHAM, and MARCUS L. TAFT,

THE GIRARD AVENUE TITLE AND TRUST COMPANY,
JOSEPH E. WIDENER,

CENTRAL UNION TRUST COMPANY OF NEW YORK, as
Trustee under the General Mortgage made by the
Reading Company and the Philadelphia & Reading
Coal and Iron Company, dated January 5, 1897,
PHILADELPHIA & READING RAILWAY COMPANY,

GREETING :

You are hereby cited and admonished to be and appear at a session of the Supreme Court of the United States to be holden in the City of Washington, in the District of Columbia, within thirty days, pursuant to an appeal filed in the Clerk's Office of the District Court of the United States for the Eastern District of Pennsylvania, wherein SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee representing holders of Common Stock of the Reading Company, are Appellants, and you are Appellees, to show cause, if any there be, why the decree rendered against the said Appellants as in said appeal mentioned, should not be corrected, and why speedy justice should not be done to the parties in that behalf.

WITNESS the Honorable J. WHITAKER THOMPSON, Judge of the District Court of the United States, this fifth day of August, A. D., 1921.

J. W. THOMPSON

District Judge.

Service of a copy of the within citation is hereby admitted this 9th day of August, 1921.

CADWALADER, WICKERSHAM & TAFT

Counsel for Adrian Iselin *et al.*,
as a Committee representing
holders of Preferred Stock of the
Reading Company.

ALEX S. LYMAN

Counsel for The New York Central
Railroad Company.

GEO. S. INGRAHAM

Counsel for Frances T. Ingraham,
Robert S. Ingraham, Mabel S.
Ingraham and Marcus L. Taft.

LARKIN, RATHBONE & PERRY

Counsel for Central Union Trust
Company of New York, as Trust-
tee etc.

ALFRED A. COOK

Counsel for Continental Insurance
Company and Fidelity-Phenix
Fire Insurance Company of New
York.

ROBERT W. DE FOREST

Counsel for The Central Railroad
Company of New Jersey and
Lehigh & Wilkes Barre Coal
Company.

Service of a copy of the within citation is hereby admitted this 15th day of August, 1921.

WM. CLARKE MASON

Counsel for Reading Company.

CHAS. HEEBNER

Counsel for The Philadelphia &
Reading Coal and Iron Company
and Philadelphia & Reading Rail-
way Company.

H. B. GILL

per J. LECH GRIMES

Counsel for The Baltimore & Ohio
Railroad Company.

T. R. WHITE, per W. T.

Counsel for William B. Kurtz and
Madge Fulton Kurtz.

GEORGE WHARTON PEPPER

by J. S. CONWELL

Counsel for Penn Mutual Life In-
surance Company.

J. C. SAUL

Counsel for The Pennsylvania Com-
pany for Insurance on Lives and
Granting Annuities.

MICHAEL J. RYAN per H. G.

Counsel for The Girard Avenue
Title and Trust Company.

ELLIS AMES BALLARD

Counsel for Joseph E. Widener.

Service of a copy of the within citation is hereby admitted this 20th day of August, 1921.

ABRAM F. MYERS

For the Attorney General of the United States.

Order Enlarging Time to Docket Case and to File Transcript.

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

SEWARD PROSSER, MORTIMER N. BUCK-
NER and JOHN H. MASON, as a com-
mittee representing holders of com-
mon stock of the Reading Company,
Appellants,

AGAINST

READING COMPANY *et al.*,
Appellees.

On reading and filing the annexed affidavit of Allen McCarty, verified the 26th day of August, 1921, and praying for the enlargement of the time of Seward Prosser, Mortimer N. Buckner and John H. Mason, as a committee representing holders of common stock of the Reading Company, appellants, to docket the case in the Supreme Court of the United States and to file the record thereof with the Clerk of said Court, it is

ORDERED that the time of said Seward Prosser, Mortimer N. Buckner and John H. Mason, as a committee representing holders of common stock of the Reading Company, to docket the case in the Supreme Court of the United States and to file the record thereof with the Clerk of said Court be and it is hereby enlarged to and including October 15, 1921.

Dated, August 26, 1921.

J. W. THOMPSON,
U. S. D. J.

Further Order Enlarging Time to Docket Case and File Transcript.

(Filed Oct. 19, 1921.)

On reading and filing the annexed affidavit of Allen McCarty, verified the 14th day of October, 1921, and praying for the enlargement of the time of Seward Prosser, Mortimer N. Buckner and John H. Mason, as a committee representing holders of common stock of the Reading Company, appellants, to docket the case in the Supreme Court of the United States and to file the record thereof with the Clerk of said Court, it is

ORDERED that the time of said Seward Prosser, Mortimer N. Buckner and John H. Mason, as a committee representing holders of common stock of the Reading Company, to docket the case in the Supreme Court of the United States and to file the record thereof with the Clerk of said Court be and it is hereby enlarged to and including November 15, 1921.

Dated, October 14, 1921.

J. W. THOMPSON
United States District Judge.

Stipulation of Counsel *re* Record.

IT IS HEREBY STIPULATED by the counsel for the respective parties in this suit, subject to the approval of the Court, that:

(a) The foregoing documents, statements and matters shall be the record, assignments of errors, and all the proceedings in the within entitled cause and shall constitute the matter to be included in the transcript of record on the appeal from the final decree made and entered June 6, 1921; and

(b) The copy marked "Transcript of Record" upon the cover and endorsed with the signatures of the Counsel for Reading Company, Adrian Iselin, *et al.*, and Continental Insurance Co., *et al.*, on the last page thereof, is a true copy of such documents, statements and matters and may be taken, used and certified by the Clerk of said Court in making up and certifying the transcript of record as a true copy of the record, assignments of errors and all the proceedings in the within entitled cause without personally making a check and comparison of the same with the documents, statements and matters on file in said Court.

Dated, November 2, 1921.

ABRAM F. MYERS, for the
United States Attorney General.

WM. CLARKE MASON,
R. C. LEFFINGWELL,
CHAS. HEEBNER,
Attorneys for Reading Company.

CHAS. HEEBNER,
Attorney for Philadelphia &
Reading Coal & Iron Co.

ROBERT W. DE FOREST,
CHARLES E. MILLER,
Attorneys for The Central Rail-
road Company of New Jersey.

ROBERT W. DE FOREST,
CHARLES E. MILLER,
Attorneys for Lehigh & Wilkes-
Barre Coal Co.

J. DU PRATT WHITE,
Attorney for Seward Prosser,
Mortimer N. Buckner and
John H. Mason, as a Committee
representing holders of
Common Stock of Reading
Company.

CADWALADER, WICKERSHAM & TAFT,
Attorneys for Adrian Iselin, Robert
B. Dodson and William
A. Law, as a Committee representing
holders of Preferred
Stock of Reading Company.

ALEX. S. LYMAN,
Attorney for The New York
Central Company.

H. B. GILL,
Attorney for The Baltimore &
Ohio Railroad Company.

T. R. WHITE,
Attorney for William B. Kurtz
and Madge Fulton Kurtz.

GEORGE WHARTON PEPPER,
Attorney for Penn Mutual Life
Insurance Society.

SAUL, EWING, REMICK & SAUL,
by M. B. SAUL,
Attorneys for The Pennsylvania
Company for Insurances on
Lives and Granting Annuities.

GEO. S. INGRAHAM,

Attorney for Frances T. Ingraham, Robert S. Ingraham, Mabel S. Ingraham and Marcus L. Taft.

MICHAEL J. RYAN,

Attorney for The Girard Avenue Title & Trust Co.

ELLIS AMES BALLARD,

Attorney for Joseph E. Widener.

JNO. M. PERRY,

Attorney for Central Union Trust Company.

CHAS. HEEBNER,

Attorney for Philadelphia & Reading Railway Company.

ALFRED A. COOK,

Attorney for Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York.

Approved:

J. W. THOMPSON,

D. J.

Copy of Clerk's Certificate.

The foregoing copy of the documents, statements and matters constituting the record, consisting of 346 consecutively numbered pages, was duly lodged in the office of the Clerk of the District Court of the United States for the Eastern District of Pennsylvania, this November 4, 1921.

GEORGE BRODBECK,
Clerk of the District Court of
the United States for the
Eastern District of Penn-
sylvania.

I, GEORGE BRODBECK, Clerk of the United States District Court, do hereby certify and return to the Honorable, the Supreme Court of the United States, that the foregoing containing 346 pages numbered consecutively from 1 to 346, both inclusive, is a true and complete transcript of the record, assignments of errors and all proceedings in the within entitled cause in accordance with a stipulation of the counsel for all the parties in this suit, a copy whereof is set forth at pages 343-346, inclusive, of said transcript, as appears from the original records on file in this Court.

IN WITNESS WHEREOF I have hereunto set my hand and affixed the seal of said District Court at Philadelphia in the Eastern District of Pennsylvania this November 7, 1921.

GEORGE BRODBECK,
Clerk.

[SEAL]

No. 609.

DEC 30 1921

WM. R. STANSBURY
CLERK

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,

Appellants,

v.

READING COMPANY, *et al.*,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN
DISTRICT OF PENNSYLVANIA.

BRIEF FOR APPELLANTS.

ALFRED A. COOK,

Attorney for Appellants.

ALFRED A. COOK,

FREDERICK F. GREENMAN,

ROBERT SZOLD,

Of Counsel.

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St. Paul, Minn.



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IN THE
Supreme Court of the United States,
OCTOBER TERM, 1921.

No. 609

CONTINENTAL INSURANCE COMPANY
and
FIDELITY-PHENIX FIRE INSURANCE COMPANY OF
NEW YORK,
Appellants,
v.
READING COMPANY, *et al.*,
Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR APPELLANTS.

Statement of the Case.

This is an appeal from a decree of the United States District Court for the Eastern District of Pennsylvania which approved a plan for the dissolution of the combination held illegal by this Court in *United States v. Reading Company, et al.*, 253 U. S. 26. So far as the plan relates to the disposition of the shares of stock of the Philadelphia & Reading Coal and Iron Company, the appellants

contend that it is inequitable and in derogation of their rights as the holders of common stock of the Reading Company.

For convenience, we shall hereinafter refer to the Philadelphia & Reading Railway Company as the Railway Company, and to the Philadelphia & Reading Coal and Iron Company as the Coal Company.

In *United States v. Reading Company, et al.*, 253 U. S. 26, this Court held that the ownership and control by the Reading Company of the stock of the Railway Company and of the Coal Company, was unlawful, and directed the District Court to make

“such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other”

of the Railway Company and the Coal Company. The decree on mandate of the District Court required the defendants to submit a plan for the dissolution of the unlawful combination (R. 36). Pursuant thereto, the defendants Reading Company, the Railway Company, and the Coal Company submitted a plan which, omitting such features as were subsequently eliminated or modified and which are not in issue in this Court, contained proposals as follows:

(1) The assumption by the Reading Company of, and the agreement of the Reading Company to save the Coal Company and its property harmless from, the General Mortgage and the \$96,524,000 principal amount of general mortgage 4% bonds, now the joint obligation of the two companies;

(2) The payment by the Coal Company to the Reading Company of \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in new 4% mortgage bonds of the Coal Company;

(3) The delivery of general releases as between

the Coal Company and the Reading Company, including a release of the Coal Company's liability of \$69,357,017.99 to the Reading Company;

(4) * * * *

(5) The creation of a new corporation to acquire the stock of the Coal Company or the interest of the Reading Company therein; such new corporation to issue 1,400,000 shares of no par value stock; such new stock to "be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each share of Reading Stock", with provisions designed to prevent common control of the Coal Company and the Railway Company.

(6) The merging of the Railway Company into the Reading Company which is to retain its name and charter (R. 40-45).

The Court ordered that the plan as originally submitted be filed and be "open to the inspection of all stockholders of the said companies" (R. 47). Thereafter, a number of petitions to intervene were filed. These were on behalf of the Continental Insurance Company and the Fidelity-Phenix Fire Insurance Company of New York, holding 8,400 shares of common stock (R. 52), the Prosser Committee representing upwards of 450,000 shares of common stock, also appellants herein (R. 102), Frances T. Ingraham holding 11,050 shares of common stock (R. 120), the Iselin Committee representing 207,397 shares of preferred stock (R. 131), the New York Central Railroad Company holding 406,600 shares of preferred and 197,050 shares of common stock (R. 140), the Baltimore & Ohio Railroad Company holding 406,600 shares of preferred and 200,050 shares of common stock (R. 142), William B. Kurtz and Madge Fulton Kurtz holding together 5,100 shares of preferred stock, the Penn Mutual Life Insurance Company, The Girard Avenue Title and Trust Company, and the Pennsylvania Company for Insurances on Lives and Grant-

ing Annuities, each holding general mortgage bonds of the Reading Company and the Coal Company (R. 144-147), and Joseph E. Widener holding 100,000 shares of common stock (R. 148).

No objection to the intervention was interposed by the Reading Company, the Government or any other party. Leave to intervene as parties defendant was duly granted to these appellants and others (R. 203) and an order entered (R. 205) setting down for argument, among others, the following questions:

1. (a) "Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful;
- (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders" (R. 206).

Argument was duly had. The plan was modified (R. 210-212) in certain aspects not now material, and as so modified (R. 274-277) approved in an opinion of the Court below (273 Fed. 848; R. 278), and by a corresponding decree (R. 287). The District Court was constituted of two Circuit Judges and a District Judge under the authority of the Expediting Act, 32 Stat. 823, c. 544; 36 Stat. 854, c. 428; and as provided by the same Act, the case comes directly to this Court.

The Facts.

The capital stock of the Reading Company outstanding consists of 2,800,000 shares of the par value of \$50 each (\$140,000,000), of which

- 560,000 shares (\$28,000,000) are non-cumulative 4% first preferred stock;
- 840,000 shares (\$42,000,000) are non-cumulative 4% second preferred stock; and
- 1,400,000 shares (\$70,000,000) are common stock.

Under the proposed plan, all holders of shares of the Reading Company, whether preferred or common, are given equal rights to acquire the shares of the new corporation for \$2.00 for each share of Reading stock. The new corporation is to issue 1,400,000 shares of no par value and is to acquire at first the right, title and interest of the Reading Company in and to all of the stock of the Coal Company and upon the discharge of the General Mortgage, the stock of the Coal Company itself. (The new corporation will be hereinafter referred to as the New Coal Company, and the right, title and interest of the Reading Company in and to the stock of the Coal Company as the stock of the Coal Company.) A holder, therefore, of two shares of Reading stock, whether preferred or common, on paying \$4.00 would have a right to one share of stock of the New Coal Company. To avail himself of the right conferred, however, the Reading Company stockholder must make an affidavit to the effect that he does not own any shares of the capital stock of the Reading Company, and is not acting for or on behalf of any stockholder of the Reading Company, or in concert, agreement or understanding with any other person for the control of the New Coal Company in the interest of the Reading Company, but in his own behalf in good faith. (R. 305). To obtain the New Coal Company stock,

therefore, a Reading stockholder must dispose of his present Reading stock. He may, however, retain his Reading stock and sell his "right" to acquire the New Coal Company stock to some outsider, who may make the required affidavit. The right to obtain the New Coal Company stock is assignable. In the normal course of events, it may be assumed that Reading stockholders would prefer to sell their assignable rights in the New Coal Company stock. In this manner the New Coal Company stock would soon pass into the hands of persons independent of and unconnected with the Reading and the Railway Companies.

Neither the Reading Company nor the Coal Company is to be dissolved or liquidated. Both will continue in business. Simply, Coal Company stock is to be transferred to the New Coal Company whose shares in turn are to be distributed.

The Distribution of Valuable Rights to Reading Stockholders.

The assignable "rights" thus to be distributed to Reading stockholders are very valuable. Such rights have been selling on the market since the plan was announced. The record discloses that they have been sold as high as \$20.00 for the right pertaining to each Reading share, and as low as \$13.50 (R. 128). On this basis the two shareholders who together own 813,200 shares of preferred stock (R. 140, 142) would receive rights on their preferred stock alone of a minimum market value of \$10,978,200.

The market value of the assignable rights to be distributed, reflects to a certain degree, the value of the Coal Company assets and business whose stock is to be distributed. If the intercompany liabilities which are to be released according to the plan (such as that for the capital stock of the Coal Company, \$8,000,000, and its debt to the Reading Company of \$69,357,017.99) are

eliminated, the balance sheet of the Coal Company for December 31, 1920, deducting every other item appearing on the liability side, shows a net worth remaining of \$103,042,447.47 (R. 198, Exhibit F of Reading answer).

This represents assets of \$111,766,454.01, less liabilities of \$8,724,007.54. Of this net worth of \$103,042,447.47, \$6,506,955.26 is in Liberty Bonds and current assets alone total \$26,803,427.37 of which \$8,245,174.27 is in cash.

The plan provides that the Coal Company shall transfer to the Reading Company, \$10,000,000 of cash or current assets, and \$25,000,000 of new 4% mortgage bonds. If these items aggregating \$35,000,000, are deducted from the net worth of the Coal Company (\$103,042,447.47) there remains \$68,042,447.47. This amount is the value of the Coal Company property to be distributed by the Reading Company, in return for \$5,600,000. If property worth \$68,042,447.47 is represented by 1,400,000 shares, each share is worth over \$48.

The figures on the 1920 balance sheet for the value of nearly all of the Coal Company's assets appear to be on the basis of the 1896 valuations, with deductions for depletion charges and additions for new property acquired. In 1896, according to representations by the Reading Company made at the time to the New York Stock Exchange, the Coal Company had

"possession of 102,573 acres of anthracite lands, owned and leased,—almost two-thirds of the entire acreage of the Schuylkill coal field,—stocks and bonds in other coal companies, coal in storage and other property, *all of the estimated value of \$95,000,000*" (253 U. S. 26, 46. R. 7-8). (Italics ours.)

The evidence on the trial showed that 40% to 50% of all the coal in the anthracite producing area of Pennsylvania belonged to the Coal Company (R. 6, 262).

The net earnings of the Coal Company for the year 1920 aggregated \$6,672,222 (R. 199) and the earnings for

the four preceding years were as follows: 1916, \$2,463,790; 1917, \$5,436,633; 1918, \$4,160,162; 1919, \$2,866,736 (R. 199); an average of \$4,319,908 per annum over a period of five years. These earnings, after the deduction of \$1,000,000 in interest payments which would have to be made upon the \$25,000,000 new 4% mortgage bonds to be delivered under the plan (R. 274), would be sufficient to pay an average annual dividend of 59% upon the price (\$5,600,000). The earnings for the year 1920 alone (after deducting the \$1,000,000 interest charges aforesaid) would be more than sufficient to pay to the holders of the stock of the New Coal Company a dividend of 100% upon an investment of \$5,600,000 and the earnings for the four preceding years would (after payment of the interest charges of \$1,000,000) be sufficient to pay dividends on an investment of \$5,600,000 as follows: 1916, 26%; 1917, 79%; 1918, 56%; 1919, 33%.

The Distribution Reduces the Large Consolidated Surplus and Leaves the Capital Stock Unimpaired.

The Coal Company, rich in net assets though it is, has a net worth less than the accumulated consolidated surplus of the Reading Company and of the Railway Company and the Coal Company, of which latter two companies the Reading Company is sole stockholder. The surplus of the Reading Company, according to the balance sheet of December 31, 1920, was \$33,996,983.01 (R. 200); of the Railway Company, \$63,706,652.09* (R. 259); of the Coal Company, \$25,685,428.48 (R. 198), or a total of \$123,389,063.58 (R. 259). The surplus has been accumulated out of earnings from year to year, since the receivership and reorganization of 1896 (R. 259). The distribution of the stock of the Coal Company therefore, *involves no impairment of capital*. Indeed, the Reading

* On the tentative balance sheet (R. 200) this figure was \$63,727,325.91.

Company has introduced an exhibit to the effect that, if the proposed plan had been fully consummated on December 31, 1920, and the New Coal Company stock distributed as originally proposed, the Reading Company would still have remaining, a surplus of \$54,115,478.43 (R. 200).*

Thus the result of consummation of the transactions involved in the plan is to reduce the consolidated surplus from \$123,389,063.58 to \$64,115,478.43 (R. 200, 259).

If, however, the balance sheet of the Reading Company alone be regarded, the consummation of the transaction would absorb its large accumulated surplus without impairing its capital stock to any material extent.

Under the plan the Reading Company is to eliminate from its assets the Coal Company's indebtedness to it of \$69,357,017.99 and the capital stock of \$8,000,000 of the Coal Company—an aggregate of \$77,357,017.99.

On the other hand the Reading Company is to receive \$40,600,000 as follows:

Cash or current assets from the Coal Company	\$10,000,000
New 4% mortgage bonds of the Coal Company (<i>at par</i>)	25,000,000
Cash from stockholders of the Reading Company	5,600,000
Total	\$40,600,000

Thus if the balance sheet of the Reading Company alone be regarded, its surplus will be reduced by \$36,757,017.99 (\$77,357,017.99 less \$40,600,000). From this, however, should be deducted an item of \$2,000,000 in an account called "Philadelphia & Reading Coal and Iron Company Special A/C" by reason of paragraph 3 (R.

* To this amount should be added \$10,000,000, as paragraph 4 of the plan originally submitted contemplated a payment of this sum to the holders of the General Mortgage bonds. Upon objection this provision was abandoned.

274) which provides for the exchange of releases of all claims and liabilities as between the Reading Company and the Coal Company,* making the net reduction of surplus \$34,757,017.99 involving an immaterial impairment of capital as of December 31, 1920, of less than \$760,000, which no doubt is entirely restored by 1921 operations. As previously stated, however, the Reading Company itself records the fact that after consummation of the transactions proposed in the plan, the surplus remaining will be \$54,115,478.43 (R. 200).

The Plan Emanates from the Board of Directors.

The plan thus to distribute the assets of the Coal Company or its stock was formulated and presented by the Board of Directors of the Reading Company (R. 148-149).

The answer of the Reading Company states that no part of the plan was adopted without careful consideration, that

“the Board of Directors of the Reading Company approached the problem from the point of view . . . third, doing justice between existing classes of security holders. The members of the Board of Directors are, and for years have been, for the most part, personally or in a representative capacity, holders of large amounts of stock, preferred or common, or both of the Reading Company . . . It has been the primary concern and guiding principle of the Board of Directors of the Reading Company, during months of anxious consideration, to devise a plan” . . . (R. 154-155).

* This elimination is made in balance sheet annexed by the Reading Company to its answer as Exhibit G (R. 200).

Control of the Reading Company is in the Preferred Stockholders.

Each share of Reading stock, preferred and common alike, has one vote.*

Of the 2,800,000 shares of stock of the Reading Company, 1,210,300 shares, or about 44% of the total, are owned by the New York Central and the Baltimore & Ohio Railroad Companies alone (R. 140, 142). This was substantially the situation in 1914 (R. 271). Of the 1,210,300 shares held in 1921 by the two railroad companies, 813,200 are preferred (R. 140, 142). Five shareholders, including the Iselin, McKean and Baer interests in 1914, owned 1,256,691 shares or about 45% of the total (R. 271). Of the shares held by the five shareholders mentioned, 848,369 or about 68%, in 1914, were preferred. As the remaining shares are widely scattered (R. 208, 209), the closely held large blocks of preferred stock constitute the dominating interest. The Board of Directors naturally respond thereto.

The proposed plan transfers to the preferred stockholders, not all, but one-half of the New Coal Company stock.

There seems no occasion to question the accuracy of the statement in the Reading Company answer that "to devise" the proposed plan (whereby the New York Central and the Baltimore & Ohio alone upon its effectuation would receive on their preferred shares rights of minimum market value of \$10,978,200, or if they disposed of their holdings in the Reading Company, would retain the control of the New Coal Company) was to the members of the Board of Directors a matter of concern "during months of anxious consideration" (R. 155).

* The present Board of Directors, according to Poor's Manual of Railroads, 1921, p. 1677, is as follows: Henry P. McKean, Daniel Willard, H. L. Bond, A. H. Smith, A. H. Harris, Edward T. Stotesbury, Jos. E. Widener, Agnew T. Dice (Pres.) and C. H. Ewing. Of these, Daniel Willard is President of the Baltimore & Ohio Railroad Company and H. L. Bond solicitor for the same (R. 142). It likewise appears from the Manual (p. 1466) that A. H. Smith is President and A. H. Harris Vice President of the New York Central Railroad Company.

The Respective Rights of the Stockholders.

The charter of the corporation throws little light on the respective rights of the stockholders. The Reading Company was created pursuant to an Act of the Legislature of the Commonwealth of Pennsylvania, approved May 24, 1871, under the name of the Excelsior Enterprise Company, and was granted the same powers as the Pennsylvania Company created under an Act of the same Commonwealth, approved April 7, 1870, as supplemented by an Act approved February 18, 1871. Under these Acts, the Company was empowered to issue both common and preferred stock and to sell or dispose of any portion on such terms and conditions as the Company should agree upon with subscribers (R. 54-55).

The acts are set forth *in extenso* in the Record (R. 189-197). Subsequently, the name of the Company was changed and the authorized issue of stock increased (R. 55-56).

The stock certificates now in question are set forth in the record (R. 88-93). The Certificates are printed as Appendix A hereto.

The Certificate for the first preferred stock provides that such stock (*italics not in originals*)

is entitled to non-cumulative dividends at the rate of but *not exceeding 4% per annum*, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year, of any dividends on other stock";

that the Board may, out of surplus for any year, declare dividends on second preferred stock

"after providing for the payment of *full* dividends for any fiscal year on the first preferred stock";

that

"the Reading Company should have the right at any time to redeem either or both classes of its preferred stock at par in cash".

The Certificate of the second preferred stock provides that it

"is entitled to non-cumulative dividends at the rate of, but not *exceeding 4% per annum* in each and every fiscal year in preference and priority to any payment in or for such fiscal year, of any dividend on the common stock, but only from undivided net profits of the company remaining after providing for the payment of the *full* dividends for such fiscal year on the first preferred stock";

that on certain conditions, the second preferred stock may be converted one-half into first preferred stock and one-half into common stock; that

"the Reading Company shall have the right at any time to redeem either or both classes of its preferred stock at par in cash."

The Certificate of the common stock provides that

"the Reading Company shall have the right at any time to redeem either or both classes of its preferred stock at par in cash"

and that*

"if from the business of any particular fiscal year, excluding undivided net profits remaining from previous years after providing out of the net profits of such particular fiscal year for the payment of the *full* dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. *But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.*"*

* The same provision is contained in the first preferred and second preferred stock certificates.

The stock certificates are now in the forms adopted pursuant to resolutions of the board of directors on September 14, 1904, in conformity with the rules of the New York Stock Exchange and the Philadelphia Stock Exchange. They are in substantially the same form as originally issued according to the resolution of the stockholders at a special meeting held December 18, 1896 (R. 78-81). The resolution of the stockholders carried out the plan and agreement of re-organization dated December 14, 1895, under which the Reading Company, which had previously been in receivership, was reorganized.

Circumstances Surrounding the Issue of the Preferred and Common Stock.

In 1892 the old Reading Railway Company and the Coal Company went into the hands of receivers, after default in the payment of interest on bonds issued under a mortgage. The receivership continued until 1896, when a scheme of reorganization was promulgated and effectuated. The Reading Company acquired the entire capital stock of the new Railway Company and of the Coal Company. The Coal Company became a co-obligor with the Reading Company on an issue of bonds limited to \$135,000,000, and joined in the execution of a mortgage on all its property to secure such bonds (R. 6, 7). Prior to the reorganization there had existed general mortgage bonds, first preference income bonds, second preference income bonds, third preference income bonds, capital stock and deferred income bonds (R. 222). Under the reorganization plan the general mortgage bondholders secured new general mortgage bonds and a small percentage of cash; the first preference income bondholders received for the face value of their claims, 30% in first and 100% in second preferred stock of the new company; the second preference income bondholders received, 65% in second preferred stock and 55% in common stock; the

third preference income bondholders received, 35% in second preferred stock and 85% in common stock. The stockholders and deferred income bondholders of the old company received common stock. The preference income bondholders and stockholders of the old company were required to pay assessments of 20%, the deferred income bondholders 4% (R. 224).

After providing a large amount of the first preferred stock for the reorganization managers and syndicate, some first preferred stock went to the first preference income bondholders; over \$40,000,000 of the total authorized issue of \$42,000,000 of second preferred stock went to the first, second and third preference income bondholders; while the common stock went to the old stockholders, the second and third preference income bondholders, and the deferred income bondholders (R. 213, 223).

The reorganization plan as submitted by the Reorganization Committee stated that the total annual fixed charges after reorganization, for interest and taxes would amount to about \$9,300,000 and that the net earnings for the two years prior to the reorganization had been as follows:

1894	\$9,839,971.32
1895, estimated as to November.....	9,624,123.00

(R. 226). For the four years prior to the reorganization, 1893 to 1896 inclusive, the deficit of the railway and coal companies had risen year by year to an accumulated deficit of \$6,883,127.94 (R. 259).

Thus, although as stated by the Reorganization Committee at the time,

“The new fixed charges will be well within the net income of the system even in the past years of extreme depression, . . .”

there was no reasonable prospect that earnings would be sufficient to justify dividends on the common stock of the reorganized company. The common stockholders thus

took the risk. On the other hand the preferred stockholders who had been previously largely creditors, might reasonably be required to be satisfied with payment of their claims at par.

Payment of Dividends by the Reading Company.

The certificates of preferred and common stock have received practical construction by the parties, continuous and uniform for many years.

The consolidated surplus of the three companies increased year by year from \$133,293.12 in 1898 to \$123,389,063.58 in 1920 (R. 259). This represents yearly accumulations from earnings.

Dividends have been paid as follows: on the first preferred stock from 1900 to date 4%, except in the years 1900 to 1902 when 3% was paid; on the second preferred stock from 1900 to date 4%, except in the years 1900 to 1902 when no dividends were paid and in 1903 only 1½% was paid. On the common stock no dividends were paid until 1905, when 3½% was paid. From 1906 to 1909 4% was paid. From 1910 to 1912 6% was paid. From 1913 to date 8% has been paid (R. 58). Thus, during the last ten years 4% has regularly been paid on first and second preferred and more than 4% on the common. In 1913 when the common stock was placed on an 8% basis the aggregate accumulated surplus was \$52,184,737.34 (R. 259).

It appears that during the ten year period in which dividends of more than 4% per annum have been paid upon the common stock, the dividends were duly declared by the board of directors, the acts of the board were duly ratified by the stockholders, information with respect to the amount of dividends thus declared and paid was published in the annual reports to stockholders, knowledge of the amount of dividends thus paid was general throughout the community, and no protest against,

criticism of, or objection to, the payment of such dividends was ever made by any preferred stockholder or anyone else (R. 58, 59). Extract from the minutes of the meetings of the board of directors of the Reading Company held December 8, 1920 and January 18, 1921, declaring dividends are printed in the Record (R. 94, 95).

The Petition of these Intervening Defendants, Holders of Common Stock.

The petition of the Continental Insurance Company and the Fidelity-Phenix Fire Insurance Company of New York, defendants-appellants, was directed largely to the question on which the court below ordered argument as follows:

(R. 206): "whether such disposition (of Coal Company stock as provided in the plan) confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders."

The Insurance Companies, common stockholders, charged that the plan conferred upon the preferred stockholders of the Reading Company great pecuniary benefits in derogation of the legal rights of common stockholders. They contended that preferred stockholders were limited according to the basic contracts between the parties, to dividends at a rate not exceeding 4% per annum, that any benefits to stockholders to be distributed by the Reading Company after the preferred received its 4% per annum, must go exclusively to the common stockholders; that the distribution of the Coal Company's stock as provided in the plan left the capital stock of the Reading Company unimpaired; that the distribution of Coal Company's stock as provided in the plan, will come out of surplus and will confer upon the preferred stockholders pecuniary rights vastly in excess of 4% per annum and correspondingly reduce the surplus available for distribution to the common stockholders.

**The Answers of the Reading Company and of the
Preferred Stockholders.**

The common stockholders were answered in the court below by the argument that the transaction involved is a sale, *not* a distribution by way of dividend, hence, cannot be objected to by any stockholder; that the consideration for the sale, though small, is "adequate for the requirements of the Reading Company"* (R. 163); that the transaction involves a dissolution or partial liquidation of the Reading Company's business and that the rights of preferred and common stockholders on dissolution or liquidation are to share equally.

Decision of the District Court Below.

The holding of the District Court as to the precise nature of the transaction is not clear. In one part of the opinion it is stated that the "offending stock" is to be "disposed of" (R. 280). In another place in the opinion it is stated that the disposition is "by sale through the agency of a corporation created under the provisions of this decree" (R. 281). The opinion continues: "It is

* The Reading Company in its answer does not anywhere allege that the price to be "paid" by the stockholders of the Reading Company for the stock of the New Coal Company is the equivalent of the value of such stock or is an adequate consideration therefor. It alleges:

"This consideration is less than it is hoped will prove to be the intrinsic value of the coal property. It is, however, a *substantial*, not a *nominal*, consideration and is in the judgment of the Board of Directors of the Reading Company *adequate for the requirements of the Reading Company*" (R. 163).

"In view of the fact that a good part of the anthracite coal fields in the country are actually or potentially on the market, it is believed the coal stock cannot be sold under pressure of the decree in this cause for a sum *as great as its book value* (R. 163)."

"The coal stock is being sold for less than its book value and it is not asserted on behalf of the intervening common stockholders that it can be sold for *as much as its book value* (R. 163, 164)."

a taking by the law of an asset of that company, *a stock asset*" (R. 281) (italics ours). "Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved" (R. 281). The opinion then goes on to state that the disposition is not as a dividend nor, indeed, as a sale, but is a distribution of a part of the Reading Company's capital, as follows:

"Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying share-holders. . . ." (R. 282).

The Court then holds that all stockholders should share alike

"on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets" (R. 282).

Appeal was allowed by the Court below on the filing of a supersedeas bond in the sum of \$750,000 (R. 321), an unprecedented sum in view of the contentions so persistently made in support of the plan that the stock of the New Coal Company to be distributed was worth no more than \$4 per share, and to be accounted for only on the basis that "rights" to the stock were selling in the market at between \$13.50 and \$20 per share (R. 128).

Issues in this Court.

The assignment of errors (R. 317-320) raises the following principal issues:

1. Does the distribution of the New Coal Company stock, as provided in the modified plan, to the shareholders of the Reading Company confer on them rights of value?
2. If so, are the preferred stockholders legally entitled to receive such pecuniary benefits?

3. Is the transaction a sale to the stockholders?

4. If it be regarded purely as a sale, is it nevertheless, in derogation of the rights of common stockholders, as being a sale by a majority to a majority for wholly inadequate consideration?

5. Is the distribution of the New Coal Company stock to Reading Stockholders from capital?

6. Is it by way of dissolution or liquidation of the Reading Company?

ARGUMENT.

Introduction.

This is a suit in equity. The bill in equity of the Government was instituted by virtue of the provisions of the Anti-Trust Act of Congress of July 2, 1890, Chapter 647, 26 Stat. 209.

It is now the settled practice of this Court, while framing decrees effectively to dissolve any illegal combination, thereby to work a minimum of damage to existing property rights and no injustice as between various classes of security holders. Thus, in the *Standard Oil* case, the decree provided for distribution ratably to shareholders of "the shares to which they are equitably entitled . . ." (see *United States v. Union Pacific Railroad Company*, 226 U. S. 470, 474). The plan in the *Union Pacific* case first proposed assumed that the distribution of Southern Pacific Company's shares would be either by sale or dividend and if by dividend that the distribution would be to such Union Pacific shareholders "entitled to such dividend . . .". 226 U. S. 470, 471.

In accordance with this policy, this Court in the instant case directed ". . . the disposition of the shares of stock and bonds and other property of the various companies held by the Reading Company . . ." (R. 25): the Court below directed a hearing on the question whether the disposition of the Coal Company's stock as proposed was an invasion of the legal rights of any class of stockholders, and directly determined such question after interventions without objections (R. 156) and after hearing.

Equity having once taken jurisdiction of this case, will be governed by three guiding principles:

(a) It will look through the forms to the realities of the situation (R. 24).

(b) It will not yield its jurisdiction until it has finally determined all the issues involved and settled the rights of all parties concerned. *1 Pomeroy Equity Jurisprudence*, 3rd Ed., Sec. 181; *Oelrichs v. Spain*, 15 Wall. 211, 228; *Clarke v. White*, 12 Peters, 178, 187; *Hepburn v. Dunlop*, 1 Wheat. 179, 197.

(c) It will not work an unnecessary deprivation of the rights of any party in interest, and will not permit such deprivation to be effectuated in its name under the guise of a plan to comply with its decree.

In support of the plan it may be contended that the Courts have power to liquidate or wind up the Reading Company and its railway and coal departments, and in so doing to override the respective legal rights of classes of stockholders. It may further be contended that any such deprivation of rights of one class of stockholders to the enrichment of another class is a necessary incident to the exercise of such power.

But whatever may be the power of the Courts to override the rights of classes of stockholders (*Harriman v. Northern Securities Company*, 197 U. S. 244), it is clear that no such deprivation or forfeiture was purported or intended to be decreed in this case.

Far from directing or compelling the stockholders to adopt a plan approved by its decree and overriding the respective rights of the classes of stockholders, the Court below directed that

“the defendants Reading Company, the Railway Company and the Coal Company shall issue calls for meetings of their respective stockholders according to law for the purpose of submitting to the *stockholders for their approval* such action as may be appropriate to carry out the provisions of the modified plan as approved and supplemented by this decree or in connection therewith” (R. 297, par. 5; italics ours).

The decree merely ordered the Reading Company, the Railway Company and the Coal Company to consummate the provisions of the modified plan (R. 291, par. 2).

The mandate of this Court directed a dissolution of the illegal bonds, but further than that it did not disturb the rights of stockholders. That the Court below did not intend by judicial decree or otherwise to interfere with or alter the existing relative rights of preferred and common stockholders is clear from the specific question propounded by it for argument:

"whether such disposition confers upon any one class of stockholders of the Reading Company any benefit to the prejudice of the *legal* rights of any other class of stockholders." (Italics ours.)

The Court intended to hold and did hold that the disposition of the Coal Company stock as planned does not confer on any one class of stockholders of the Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

The correctness of that holding is the issue presented on this appeal.

I.

The substance of the transaction is the distribution to Reading shareholders of valuable property of the Reading Company, leaving its capital stock unimpaired: hence it is a dividend.

In *Stone v. United States Envelope Company, (Maine)*, 111 Atl. 536 (1920), the Board of Directors of a Corporation proposed to sell its stock at \$150 per share, to both common and preferred stockholders in proportion to their holdings. The price was materially below the value of the stock sought to be sold. The preferred shares were entitled to cumulative dividends of 7%. On suit by

a common stockholder, the Court enjoined the proposed sale; and held that the transaction constituted a dividend of the difference between \$150 per share and the market value. Preferred stockholders having received their 7% were held not entitled thereto.

The doctrine of this case, if adopted, is sufficient to dispose of the instant case.

A similar holding was made in *Russell v. American Gas & Electric Company*, 152 App. Div. (N. Y.) 136. There, the plan was to sell common stock at par, to common stockholders only. The market value of the common stock was about \$30 above par. A preferred stockholder brought suit to enjoin execution of the plan unless he was permitted to participate. Injunction was denied, on the ground that the preferred stockholder had received his preference dividends and any distribution in excess thereof, *i. e.*, the difference of \$30.00 between the market value and the sale price, should go to the holders of the common stock. The Court said:

(p. 138) : "Where a corporation has property in excess of the amount of its capital stock, the excess is surplus which may be divided among the stockholders entitled to share therein, either in money or property. (*Williams v. Western Union Telegraph Co.*, 93 N. Y. 162.) As a holder of the preferred stock the plaintiff could claim no interest in such excess. So long as the dividends upon his stock were paid, and the defendant had property equal in value to the amount of its outstanding capital stock, after the payment of its debts, the corporation, if it saw fit to do so, could distribute all the rest of its assets among the holders of its common stock and the plaintiff would have no ground for complaint.

"It is not claimed that the capital stock of the defendant has been impaired, or that it could not legally issue the additional stock at par. That being so, whatever value the stock had above par represented surplus and was available for distribution among the holders of its common stock."

In the instant case, the record shows that the stock of the New Coal Company, which it is planned to distribute to the Reading stockholders, share and share alike, at \$4 per share, has a market value materially in excess thereof. As the plan would create in every Reading stockholder a right to receive one-half of an assignable certificate of interest in the New Coal Company stock at \$2 per share of Reading stock, and such rights have been selling at from \$13.50 to \$20.00, the market value of the Coal Company's stock has been between \$31.00 ($\$13.50 \times 2 + \4) and \$44.00 ($\$20 \times 2 + \4) per share (R. 128; *supra*, p. 6). The market value of the New Coal Company stock is thus 8 to 11 times its "price". The dividend plainly is from \$13.50 to \$20.00 per share of Reading stock.

The essence of the plan, as in the *Stone and Russell* cases, is the distribution to shareholders *pro rata* of the excess which the assignable interests in New Coal Company stock are worth, above \$2.00 per share. The minimum benefit to the two largest Reading shareholders, The New York Central and the Baltimore & Ohio Railroad Companies, solely on their preferred stock, would be \$10,978,200 (813,200 preferred shares \times \$13.50). The *Stone and Russell* cases are really *a fortiori* cases, for in those cases stock of the corporations themselves was distributed while in the case at bar, it is tangible property owned by the corporation, *i. e.*, stock of the Coal Company. While the issuance in those cases of new stock disturbed the proportionate interest in the management of the corporation which the preferred stockholder theretofore held, in the instant case, however, the distribution of rights to stock in the New Coal Company does not disturb the proportionate interest of the holders of preferred stock in the management of the Reading Company.

The distribution to Reading stockholders of the "rights" to New Coal Company stock is in itself a dividend. Such rights are assignable, salable, easily convertible into cash. Under the cases of *United States v.*

Phellis, Rockefeller v. United States and *The New York Trust Co. v. Edwards*, # 260, # 535 and # 536, respectively, Oct. Term, 1921, decided November 21, 1921, and discussed later, no one can doubt that the transaction in question amounts to a dividend.

The payment by Reading Company stockholders of \$2.00 for each share of stock held by them is no more than a nominal assessment at the time of the dividend. In the *Stone* case, payment of \$150 per share, and in the *Russell* case, payment at par by shareholders did not convert that which otherwise was a dividend into something any the less a dividend.

The actual value of the distribution to stockholders by means of New Coal Company stock is more accurately determined perhaps by reference to the Coal Company balance sheet. From this, it appears that the Coal Company properties, after deducting all liabilities, including the \$25,000,000 new 4% mortgage bonds and \$10,000,000 cash or current assets to be transferred to the Reading Company, are valued at \$68,042,447.47 (*supra*, p. 7). Since there are to be 1,400,000 shares, the value of each share must be about \$48. On this tangible basis, the dividend is \$22 (one share of Reading stock being entitled to $\frac{1}{2}$ share of New Coal Company stock on payment of \$2).

The very least that the Reading Company directors can contend the Coal Company is worth is \$77,357,017.99, for the Coal Company stock and debt* to the Reading Company are carried at that figure on the Reading Company's books. This figure is taken, of course, prior to the deducting of \$35,000,000 to be transferred to the Reading Company. Even at such book figures, however,

* In the court below, a suggestion was made by the Reading Company which was not pressed, that the \$69,357,017.99 indebtedness of the Coal Company to the Reading Company was not *bona fide* but a mere book entry. This Court, however, has treated the debt as valid and subsisting (253 U. S. 26; R. 14-15). Interest has been paid by the Coal Company to the Reading Company on the debt in occasional small amounts from 1896 to date (R. 15).

after deducting the \$35,000,000, the Coal Company is worth \$42,357,017.99, or \$30 per share, for 1,400,000 shares. On this basis the dividend is \$13 (one share of Reading stock, being entitled to $\frac{1}{2}$ share of stock of the New Coal Company on payment of \$2).

However considered and whatever names be indulged in, and howsoever the transaction be colored with other matters, and whether denominated sale, assessment, dissolution or liquidation, the plain fact is that it is planned to give preferred stockholders, by way of distribution of New Coal Company stock, a dividend of from \$13.50 minimum market value, to \$22. actual value, per share.

This is the essence of the present case. All else is detail. The opposing contentions are largely an effort to confuse, by argument, however plausible, the issue thus presented.

A dividend is a dividend, however circuitous the route.

It is settled law that dividends need not be paid in cash. Dividends may be in the form of property, such as stock or rights to stock. *Williams v. Western Union Telegraph Company*, 93 N. Y. 162.

Moreover, it is not essential that the resolution of the board of directors denominate the distribution as "dividend". This was the holding in the *Stone and Russell* cases, *supra*, and in the *Phellis* and *Rockefeller* cases. Indeed, the formality of a resolution of the board of directors is not indispensable *City of Allegheny v. Pittsburgh, A. & M. P. R. R. Co.*, 179 Pa. 414, 423; *Hartley v. Pioneer Iron Works*, 181 N. Y. 73, 79; *Smith v. Moore*, 199 Fed. 689, 697; *Grants Pass Hardware Co. v. Calvert*, 71 Ore. 103.

As the Court said in *In re Wilson's Estate*, 85 Ore. 604, 618, "A division of profits without the formality of declaring a dividend is equivalent to a dividend". This

language is also found in *Hartley v. Pioneer Iron Works*, 181 N. Y. 73, 79.

In *Wilder v. Tax Commissioner*, 234 Mass. 470, the Court said:

(p. 474): "Indeed it is not suggested that the corporation can legally distribute its profits among the joint owners except as a dividend. . . . The word 'dividend' carries no spell with it. While usually in cash, it is not necessarily so but may be issued in the form of stock or notes."

In *Smith v. Moore*, 199 Fed. 689, the Court said:

(p. 697): "So may a court of equity which always looks through the form to the substance of things . . . treat as dividends all amounts received in consequence of the division of profits of a corporate business."

The contention that there is no dividend because the stock of the Coal Company is capital investment is unsound.

It is contended, and the court below held, that the Coal Company's stock "is in no sense an earning of the Reading Company" but is "*a stock asset* which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself" (R. 281). (*Italics ours.*)

In point of strict fact, the original Coal stock is not to be distributed. Stock of a new coal company is to be distributed.

The contention then amounts to this: That assets originally contributed on the formation of the company may never be converted into cash or other property and such cash or other property disposed of to stockholders as a dividend, no matter how great the surplus accumulated out of earnings. This is not the law. This Court examined similar contentions in the *Rockefeller* and *The New York Trust Company* cases and found them without merit (*infra*, pp. 37-40).

The contention involves a fundamental misconception of the nature of capital stock, of surplus and of dividends. Capital stock is the amount originally contributed by stockholders which makes up the fund held out to creditors and to the public as the invested capital of the corporation. A corporation is given certain privileges by the State. The state requires, for the protection of the public and of creditors, that the capital stock of a corporation be not impaired by distribution of any part thereof to stockholders without legislative sanction.

Dividends may not be paid which impair capital. Capital may not be distributed to stockholders. A corporation may not purchase its own stock at all in some jurisdictions because it involves a return of capital. In others, a corporation may not purchase its own stock, unless there be a surplus sufficient to pay for the stock. Capital stock may be reduced only where legislative authority therefor exists. So serious a matter is the distribution of capital in any form that many jurisdictions have declared it a criminal offense.

This capital stock has been commonly known in the cases as a "trust fund". So long, however, as this trust fund be not impaired, any property in excess thereof after deducting liabilities may be distributed to stockholders. Such excess is known as "surplus". Dividends may be declared out of surplus.

It matters not how the surplus arises. It may be that the original property making up the trust fund remains in the corporation in specie. It may be, however, that the original property has been converted time and again into other forms. It may be that the original property has been augmented by way of fixed improvements and all cash earnings of the corporation used up in this manner. In such case, the corporation may borrow cash to the extent of the surplus and distribute the borrowings as dividends.

As said in *Williams v. Western Union Telegraph*

Company, 93 N. Y. 162, referring to earnings which had become reinvested in the property:

(p. 192): "It was commingled with other property of the company and used for corporate purposes but it was not beyond the reach of the dividend making powers of the directors. They could reclaim it for division among the stockholders and, if practical, convert it into cash for that purpose. They could borrow money on the basis of it and divide that."

and as said in *Morawetz on Corporations*, 2d Edition, Section 438:

"It may even be proper to borrow money for the purpose of paying a dividend, provided a surplus would remain after deducting the amounts of the company's capital and indebtedness from the fair value of the assets which it owns."

See also *Alabama Consolidated Coal & Iron Co. v. Baltimore Trust Co.*, 197 Fed. 347, 352.

In *Excelsior Water & Mining Co. v. Pierce*, 90 Cal. 131, a suit by a corporation against a former director to recover the amount of dividends paid to stockholders on the ground that dividends had not been paid out of surplus, where the plaintiff to support its contention, proved that the corporation had borrowed money to pay the dividends, the court held that the evidence was immaterial and said:

(p. 143): "A mining company is working its mines at a profit, but discovers that they can be worked to better advantage by constructing a new tunnel; that is to say, it will be wise economy to incur an expense of, say, \$100,000 to construct such a tunnel. . . . Clearly, we think the corporation would be justified in incurring a debt to that amount to carry out the object, and that it could go on declaring dividends after providing for the payment of the accruing interest and for the gradual extension of the principal of such debt."

"But suppose, instead of borrowing in advance to meet payments on the tunnel, it makes some payments out of the current profits which its mining operations provide, justly applicable, at its option, to the payment of dividends. . . . Afterwards it borrows money, no more than it might have borrowed originally on account of the tunnel, and out of the money so borrowed, replenishes the fund applicable to dividends. In such a case, the result is precisely the same as if the money had been borrowed sooner and the identical money borrowed, paid out on the tunnel. Nothing has been accomplished beyond what the directors had a right to do, and surely the mode in which it has been done can make no difference."

It is to be noted that the Reading Company stoutly maintains that the distribution will not impair capital (R. 165, 169, *et seq.*, 200), as it must if it comes out of capital. The President of the Reading Company states (R. 201) that after consummation of the transactions contemplated by the plan, the surplus of the Reading Company will be \$54,115,478.43 (without including \$10,000,000 which prior to the modification of the plan, was to be turned over to the bondholders). The Reading Company directors do not intend to violate the law against impairment of capital (*infra*, p. 76).

Since the fact in this instance and the intention conform, the distribution must come out of "surplus", and we may proceed to the next phase of the contention that there is no dividend.

**The "Ploughed Back" Theory Asserted by the
Reading Company is Unsound.**

The answer of the Reading Company stated:

"The accumulated surplus of the Reading Company has been ploughed back into the property and is not in form available for current dividends (R. 171) . . . the property (railway company) surplus has been ploughed back into the properties and

has become part of its corpus. It has been spent for the enlargement of the plant and for the increase of facilities. It has been so woven into the warp and woof of the structure as to have become an integral part of it" (R. 173).

The contention here is a variation of that just considered. As has been said, it proceeds on a fundamental misconception of the nature of "capital", "surplus" and "dividend". If the contention were sound, it would never be possible to use as a basis for dividends, a single dollar that had been re-invested in the fixed assets.

The decided cases have settled the matter. That by capital is meant the fund or value which the corporation must maintain for the benefit of creditors was early enunciated.

See:

Wood v. Dummer, 3 Mas. (U. S.) 308;
Sawyer v. Hoag, 17 Wall. 610;
Scovill v. Thayer, 105 U. S. 143.

The capital is a constant and not a variable fluctuating from day to day by "ploughing back". As said by MR. JUSTICE SWAYNE in *Farrington v. Tennessee*, 95 U. S. 679, 686:

"The capital stock is the money paid or authorized or required to be paid in as the basis of the business. . . . The amount authorized cannot be increased without proper legal authority. If there be losses which impair it, there can be no formal reduction without the like sanction."

As said in *Canfield v. Morristown Fire Association*, 23 N. J. L. 195:

(p. 196): "The phrase 'capital stock', as employed in acts of incorporation, is never, that I am aware, used to indicate the value of the property of

the company. It is very generally, if not universally used to designate the amount of capital to be contributed by the stockholders for purposes of the corporation. The amount thus contributed constitutes 'capital stock' of the company. The value of the stock may be greatly increased by surplus profits or diminished by losses but the amount of the capital stock remains the same.

"The funds of the company may fluctuate. Its capital stock remains invariable, save by legislative enactment."

See also:

Markle v. Burgess, 176 Ind. 25, 27;

Person & Reigel Co. v. Lipps, 219 Pa. 99, 109;

Christensen v. Eno, 106 N. Y. 97, 100;

It has seemed to us elementary that the assets of a corporation are not ear-marked, part available for dividends and part not, but that the entire corporate assets, however derived, collectively constitute its capital and accumulated profits, any part of which may be distributed to the stockholders subject only to the restriction that assets be retained equal in amount to the liabilities plus the par value of the outstanding shares of stock.

Hubbard v. Weare, 79 Iowa, 678, 689;

Williams v. Western Union Telegraph Co., 93 N. Y. 162;

Bassett v. U. S. Cast Iron Pipe Co., 74 N. J. Eq. 668, 674;

Anderson v. Farmers Loan & Trust Co., 241 Fed. 322, 326, 328.

Lubbock v. British Bank of South America, L. R. (1892), 2 Ch. Div. 198.

In the *Lubbock* case, a trading company having a paid up capital of £500,000 sold a part of its "undertaking", consisting of a banking business in Brazil. After enter-

ing into various contracts in connection with the transaction and paying certain commissions, the Directors resolved to credit to Profit and Loss account the sum of £205,000 as the amount remaining over and above the paid up capital. Suit was brought by a stockholder to restrain the Directors from dealing with the amount as if it were income, on the ground that the assets sold were part of the capital and profits therefrom involved an accretion to capital. The suit was dismissed. CHITTY, *J.*, said:

(p. 200) : "This is a trading company, and I have before me a balance sheet of 1891, to which I refer by way of illustration, to show how the accounts of such a banking company are kept, and properly kept, in my opinion. I have before me the Defendant company's accounts up to December, 1890. They put down on the one side their liabilities, treating properly the £500,000 which has been subscribed by the shareholders, as a liability, for the purpose of bringing it into account, as against the assets which they put down on the other side. Then on the same liability side they properly put their current liabilities, and certain other liabilities and reserve fund, which the company, according to its constitution, is justified in making, and they add up the total amount of those liabilities. On the other side they put down their assets, and for the purpose of giving information to the shareholders, they divide the assets into certain heads, 'cash at bank', 'bank premises, and managers' residences in Brazil and River Plate', and then they add up the total on that side. . . . Then when the two sides of this account are compared, there is a surplus of £44,000 shewn, which goes, according to the accountant's regular method of keeping accounts, to the liability side, and represents the balance of assets over liabilities. Now what is the result of keeping an account in this form? The capital of the bank is intact and the account shews it, and after providing for the capital, there remains a surplus which rightly goes to the profit and loss account.

"All that the company is required to do, by force

of the Companies' Act of 1862, is to keep its capital intact, and not to pay dividends out of its own capital; in other words to keep that capital for its creditors and any others who may be concerned therein

"I say I have great difficulty in following the first portion of the argument for the plaintiff, because it was said that what was sold was part of the capital of the company, and that what came in over and above the £500,000 was an accretion to capital, therefore it must be kept intact as part of the capital. That has, with great respect to the counsel who put forward this argument, nothing to do with the matter. The sale being an authorized sale, it is immaterial what is the thing sold . . . The capital which has to be regarded for the purpose of the Act of Parliament is the capital according to the Act and not the things, whether houses, goods, boots or shoes, or hats, or whatever it may be for the time being representing the capital, in the sense of being things in which the capital has been laid out."

In *Smith v. Dana*, 77 Conn. 543, 553, the Court said :

"The quality and incident of surplus, however invested or employed, are not the same as those of capital within the strict meaning of that word. . . . It is not so of undistributed profits or surplus in any form. . . . The manner of utilization may be changed, investments altered, permanent property sold and turned into cash . . . with no such artificial consequence that the assets so employed change their character as the result of the process. Investment in permanent works does not and ought not to capitalize. . . . Capital of this kind does not bear the perpetual stamp of capital."

In *The New York Trust Company v. Edwards* (274 Fed. 952), the *Prairie Oil & Gas Company* and the *Ohio Oil Company* each had pipe lines which either had been originally contributed in specie, or had subsequently been "ploughed back" as part of the fixed assets.

It was strenuously contended that the distribution was of capital assets. The opinion by LEARNED HAND, J., to the contrary commenced as follows:

(274 Fed. 952, 953): "Neither the Prairie Gas & Oil Company nor the Ohio Oil Company for any moment of time owned the pipe line shares as free assets."

The court proceeded:

(p. 954): ". . . A dividend may be income to the stockholder, though declared out of property which has long since become a part of the economic capital of the corporation. . . . But it makes no difference that it distributes to the stockholder property which is not current profit, but the means of producing current profit."

This Court affirmed that view and held that "the new pipe line company shares were in substance and effect distributed by the oil company to stockholders"; that this constituted "in effect a dividend out of accumulated surplus", and "was in substance and effect, not merely in form, a dividend of profits by the corporation. . . ."

It is plain that whether the pipe lines in those cases, and the coal lands in our case, be regarded as original capital or as "ploughed back", the essence of the transaction as a dividend distribution is not changed.

The Contention that the Distribution of the Coal Company's Stock is Compulsory, hence Not a Dividend, is Unsound.

Such contention was made in the court below. The District Court held that the distribution "is a taking by the law of an asset" (R. 281).

In fact, the mandate of this Court does not require the Coal Company's stock to be distributed to Reading Company preferred stockholders. Disposition of the stock of the Coal Company is directed, but the mandate leaves undisturbed the respective rights of classes of stock-

holders. An easier way of disposition, than that provided in the plan perhaps, would have been sale on the market, either directly by the Reading Company or through a trustee. Stock owned by other corporations, whose holding thereof has been condemned, is being disposed of by *bona fide* sales to persons unconnected with them (R. 298-300). Indeed, if distribution to stockholders is desired, such distribution should be made to those legally entitled thereto. If there be any compulsion in the law, the rights to buy Coal Company's stock should be offered not to the preferred stockholders but exclusively to the common stockholders.

The *Rockefeller* and *The New York Trust Company* cases (*infra*), again furnish an analogy. In those cases, the Act to Regulate Commerce and the Federal Trade Commission Act furnished the occasion for segregation of the pipe line properties and business from the oil company business, and for the distribution of new pipe line company stock; and in those cases, as in the instant case, the beneficiaries contended that the distribution did not constitute a dividend. The contention is without merit.

The Rockefeller and The New York Trust Company Cases Support the View that the Distribution is a Dividend.

This Court in *Rockefeller v. United States* and *The New York Trust Company v. William H. Edwards*, No. 535 and No. 536, respectively, October Term, 1921, decided November 21, 1921, passed upon the essential nature of the transaction required by the plan in this case. In those cases by reason of apprehended conflict of tribunals invested with power to regulate interstate commerce, separate business enterprises of corporations were transferred to new corporations and the stock delivered in consideration of such transfer by the latter, distributed to the stockholders of the former. The *Prairie Pipe Line*

Company stock never came into the possession of the transferring corporation, the Prairie Oil & Gas Company, but was delivered directly to the stockholders, just as the stock of the New Coal Company will not, under the plan, come into the possession of the Reading Company, but will be delivered directly to the stockholders of the Reading Company. In that case, as in this case, the stock was distributed by resolution of the transferring corporation which denominated the distribution something other than a dividend. There, as here, a distinct enterprise was transferred to the new corporation, an enterprise which was a part of the assets which contributed substantially to the earnings of the company. The assets transferred were either part of the original capital in specie or had been "ploughed back" out of earnings. There, as in this case, the companies each had a surplus sufficient to cover the value of the property distributed, the distributions left the capital of the companies unimpaired and required no reduction in their outstanding issues of capital stock.

Counsel for the stockholders in that case urged upon this Court in one form or another the contention that the distribution was not in the nature of a dividend, because it was merely the transfer from one corporation to another, having the same stockholders, of physical capital assets constituting a distinct line of business of the former corporation.*

*In their brief counsel for The New York Trust Company and John D. Rockefeller said:

"We apprehend that in this Court the Government may advance the proposition that * * * those stockholders should, * * * be treated as having received the pipe line properties themselves and a part of the surplus of the oil companies.

* * * it is to pervert the entire nature of the transaction—to convert into a distribution of surplus to stockholders, what was in purpose, in consummation and in result a transfer from one corporation to another of physical capital assets constituting a distinct line of business upon condition that the interest of the stockholders therein should be preserved—to metamorphosize a business readjustment of the ownership of corporate assets into a fictitious dividend.

But this Court held that the distribution was in effect a dividend out of the accumulated surplus. MR. JUSTICE PITNEY writing for the Court, said:

"We deem it to be too plain for dispute that in both cases the new pipe line company shares were in substance and effect distributed by the oil company to its stockholders; as much so in the case of the Kansas company where the new stock went directly from the pipe line company to the stockholders of the oil company, as in the case of the Ohio company where the new stock went from the pipe line company to the oil company and by it was transferred to its stockholders. Looking to the substance of things the difference is unessential. In each case the consideration moved from the oil company in its corporate capacity, the new company's stock issued in exchange for it was distributed among the oil company's stockholders in their individual capacity, and was a substantial fruit of their ownership of stock in the oil company, *in effect a dividend out of the accumulated surplus.*

It was in substance and effect, not merely in form, *a dividend of profits by the corporation, . . .*".
(Italics ours.)

In those cases this Court was confronted by a difficulty which does not exist in this case. In those cases the stockholders of the new companies were also stock-

The fact that business plant constituting an integral part of the enterprise was transferred cannot be ignored. The reason is, not that a distribution of earnings may be disguised by making it in the form of property instead of cash, but that in the nature of things any distribution by a corporation of all of its property or of a part of its property which constitutes a distinct line of business (or of the proceeds of the disposition thereof) is something more than (something radically different from) a mere distribution of property" (Brief of Counsel, pp. 18, 19).

"* * * If the answer of the Government is that it was to the pipe line companies that the transfer of surplus was made, our reply is, first, that there was no transfer of surplus, that the transfer was of tangible capital business assets which, necessarily reduced, but did not transfer, the surplus" (Brief of Counsel, p. 25).

holders of the old companies; but in the instant case the decree of the Court provides that the corporations shall be free from common domination and control, and that a holder of a certificate of interest in stock of the New Coal Company can obtain such stock only by making an affidavit to the effect that he is not a stockholder of the Reading Company.

Thus the *Rockefeller* and *The New York Trust Company* cases disposed of the following points in the instant case:

(1) There was a distribution of physical so-called "capital" assets. Yet this was held to be a dividend.

(2) There was also what might be called a partial liquidation. Yet this did not have the effect of negating the dividend.

(3) The board of directors took action but endeavored to denominate the action which they took something other than a dividend. Yet the distribution of Pipe Line Company stock was held to be a dividend.

(4) The court looked through all forms and guises and saw the essential nature of the distribution as a dividend distribution.

A segregation of properties, which have been employed to violate the Sherman Act, is within the doctrine of those cases. Indeed the lower Court which correctly decided *The New York Trust Company* case, regarded a dissolution under the Sherman Anti-Trust Act as analogous in effect to the situation presented in the *Prairie Oil* and *Ohio Oil* segregations (274 Fed. 952, 956). What was said of those segregations was intended to apply with equal force to segregations under the Anti-Trust Act.

II.

The distribution of New Coal Company stock confers benefits on the preferred stockholders of the Reading Company in violation of the legal rights of the common stockholders.

1. The rights of the respective parties are determined by the stock certificates.

The basic agreement between the parties, on which their respective rights depend, is embodied in the stock certificates which have been issued. Respective rights of stockholders of various classes may be prescribed by statute, or by the charter of the corporation. In this case, however, the statutes and the charter of the Reading Company are silent on the matter. The Reading Company had full power to issue and stockholders to accept, stock of the kind mutually agreed upon. Stock certificates of definite form were issued and accepted. While many matters such as the uniform course of conduct in the payment of dividends, the resolution of the Board of Directors providing for the issuance of the certificates, and the reorganization plan of December 14, 1895, throw considerable light upon the proper interpretation of the basic agreement, the agreement is embodied within the four corners of the stock certificates and to these certificates we must turn in the first instance.

The certificates were first issued some twenty-five years ago. Another issue of non-cumulative 4% preferred and common stock in practically identical terms was brought out in connection with the reorganization of the Baltimore & Ohio Railroad Company at about the same time. With respect to the Baltimore & Ohio certificates, question soon arose as to the right of the preferred stockholders to share in dividends in excess of the stated 4%. The Court of Appeals of Maryland held in

1901, in *Scott v. Baltimore & Ohio Railroad Co.*, 93 Md. 475, 498, as follows:

"The solution of the question with which we are now dealing must depend therefore, upon the construction to be placed upon the agreement of the parties as expressed in the stock certificates, that must be taken as the embodiment of the contract, and the final expression of the entire measure of the dividend rights of the parties."

The stock certificates in question are set forth in full as Appendix A hereto (R. 88-93). The authorizing resolution of the Board of Directors is in practically identical language (R. 78-81).

As was said in *Scott v. B. & O. R. Co.*, *supra*:

(p. 498) : "Evidence of the situation of the parties, the objects and purposes for which the agreement was made, and, in a case like this, when it is important to decide whether the certificate contains the whole agreement, all the agreements and resolutions which preceded and authorized the issue of the stock, may be resorted to, for the purpose, not of altering the contract, but of arriving at the real intention of the parties as expressed in the written contract."

2. Preferred stock is by its terms limited to dividends "not exceeding 4% per annum".

The language in the stock certificate not only of the preferred, but also of the common shares, and in the resolutions of the board of directors could not be more clear in their specific limitations. Beyond 4% per annum, the preferred stock may not go.

3. Dividends "not exceeding 4% per annum" constitute the "full dividends" to preferred stock.

But the Company's resolutions creating these classes of stock and the stock certificates do not rest with the limitation of the preferred stock to dividends "not exceed-

ing 4% per annum". Care is taken to make it clear that this 4% annual dividend is not merely a prior dividend or a preferred dividend. The documents specifically state that the maximum dividend named is the "*full dividend*" on the two classes of preferred stock, and, lest there be any remaining doubt, the creating resolutions in describing the first preferred stock, first set forth the maximum dividend rate on such stock and then refer to the "*full dividend*" on such stock, and emphasize this by referring to "*the full dividends*" on both classes of preferred stock. In describing the second preferred stock, the resolutions are careful to set forth again the maximum dividend rate on such stock, and to refer to "*the full dividends*" payable on both classes of preferred stock. The same emphatic repetition is used in the certificates for both the first and second preferred stock.

The certificates issued for the common stock emphasize to their holders not only that the other classes of stock have a prior right to dividends, but after these "*full dividends*" for the preferred stock have been paid, any other distribution from surplus net profits would go to the common stock. Otherwise the common stock certificates would merely have indicated that the preferred stock was entitled to payment of 4% per annum prior to the payment of any dividend on the common stock. But the Company concluded the matter by indicating in the common stock certificate that the dividend rate of the preferred stock which had priority was also the "*full dividend*" payable to the preferred stock.

4. The terms providing that the preferred stock may be redeemed at par emphasize the limitations of the preferred.

Lest there be any doubt on the question, the resolutions and the certificates specifically provide against any claim by the preferred stock to more than its

par value and such maximum 4% dividends per annum, by reserving to the Reading Company, *"the right at any time to redeem either or both classes of its preferred stock, at par in cash, if such redemption shall then be allowed by law"*. The resolutions make this reservation immediately following the description of the first preferred stock, and repeat this reservation immediately following the description of the second preferred stock.

The limitation of the preferred stock to a realization of its par value was from the very beginning regarded, not merely as a limitation on the preferred stock, but as an asset of the common stock. Although the limitation on the preferred stock was necessarily included in each certificate for preferred shares, it would have been superfluous as a limitation of the preferred stock in the certificates for the common stock, in which it is nevertheless introduced, if it had not been intended to emphasize the fact that the limitation of the preferred stock to a realization of its par value, operated to vest in the common stock all the remaining equity of the property.

5. The practical construction of the contract supports this view.

Were the contracts ambiguous, the practical construction given by the parties would be conclusive against the preferred stockholders.

At no time in the entire history of the Reading Company has it ever paid to the preferred stock any dividend, or made any distribution to the preferred stock, which has yielded that stock more than 4% per annum. For eleven years the Reading Company has declared dividends on the common stock in excess of those paid to the preferred, and in the last eight years of that period the common stock has received dividends twice as large as those paid to the preferred.

This practical construction by the interested parties is doubly significant because, during the eight years when the common stock received 8% and the preferred stock was limited to 4%, all parties were faced by the possibility that the Company might be obliged to make a distribution of some of its assets to at least some of its stockholders. The Government's dissolution suit was instituted in 1913.

In *Niles v. Ludlow Valve Mfg. Co.*, 196 Fed. 994, the Court says on page 995:

"it remains true that when a considerable number of persons raise no objection for many years to a method of interpreting a contract capable of being interpreted in another way, such a silence is a fair argument that the practical construction given to the contract by those who originally entered into it, is strong evidence that what was done was what they meant to have done."

6. The Reorganization Plan of 1895 confirms this view.

Under the reorganization plan, the preferred stock went largely to previous preference income bondholders (R. 221, 222). Thus, it represented debts which, according to their tenor, were not to be paid except out of earnings. The creditors, that is the previous preference income bondholders, no doubt would have deemed themselves fortunate ever to be paid in full the face value of their claims. They were not entitled to more.

Accordingly, no doubt, express provisions were inserted in the stock certificates providing for the redemption at par of the preferred stock. Those who took the common stock, who with others were required to pay a 20% assessment (R. 223), must have had little hope and no expectation of early dividends. Theirs was the risk, and theirs also the chance of possible future rewards.

Since the reorganization plan provided that the preferred stock should go largely to previous creditors, it

was proper to insert certain provisions for their security. It was provided that the stock of the Reading Company should be divided half into preferred and half into common, and it was contemplated that the preferred might be redeemed and also partially converted into common stock. Thus control of the Reading Company by common stockholders was a reasonable possibility. It was contemplated that in future years, the common stockholders having control, might refuse to declare dividends on the preferred, and the preferred stock, being non-cumulative, would have no remedy. To guard against this contingency, express provisions were inserted in the certificates of the common stock as follows:

"If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. *But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.*" (Italics ours.)

Coupled with the provisions for redemption of preferred stock, the provisions quoted clearly show that preferred stock under no circumstances should receive more than 4% dividends, and that all surplus above the par value of the preferred stock should go to the common stockholders.

7. The opposing contentions.

It may be contended by opposing counsel that the language of the stock certificates quoted, limits the declaration of dividends to common stockholders to the

particular year immediately following the making of net profits; and that if dividends are not then paid to common stockholders, they may never be declared and paid. No such extraordinary provision, however, appears in the certificates. The language is not that

no dividends shall in any year be paid upon any such other stock out of net profits of *the preceding* fiscal year

but that

"no dividends shall in any year be paid upon any such other stock out of net profits of *any* previous fiscal year"—

Furthermore, the quoted language only refers to previous fiscal years

"in which the *full* dividends shall *not* have been paid on the first and second preferred stock" (R. 93).

Suppose the construction contended for by opposing counsel be correct. Once a fiscal year has passed, no matter how great the earnings in that year, assuming that first and second preferred stockholders received their full 4% dividends for the year, the common stockholders would not be entitled to dividends out of that year. The common stockholders, in order to be protected, would have to strip the company of its entire surplus earnings immediately after being earned. In such case, if the common stockholders obtained control, there would be no reinvestment in improvements, and the company would be in the position in which no conservatively conducted business could afford to be.

8. The authorities support this view.

In *Scott v. B. & O. R. Co.*, 93 Md. 475, stock certificates almost precisely the same as those now

under consideration, were in question. The Baltimore & Ohio preferred certificates provided as follows:

(p. 504) : "The holders of preferred stock . . . are entitled to receive in each year, out of the surplus net profits of the company for the current year, such yearly dividend (non-cumulative) as the Board of Directors of said Railroad Company may declare, up to, but not exceeding, four *per centum*, before any dividends shall be set apart or paid upon the common stock."

Preferred stockholders brought suit and contended that they had the right not only to receive the 4% dividend but also to share *pro rata* with the common stockholders, in the distribution of the residue, or to share equally with the holders of the common stock in any part of the net earnings distributable after the payment of the 4% dividend each to common and preferred stockholders. The Court held that the preferred stockholders were limited to the 4% dividend and that any earnings in excess of the 4% preferred dividend could be distributed only to the common stockholders. The Court said, 49 Atl. 330:

"Why were the words 'not exceeding' thus inserted? What is their significance? If it was only to indicate that the 4 per cent. was the largest amount that could be received before the common stock was entitled to a share of the earnings, the words 'up to' would have been quite sufficient, and the other words would have been surplusage. But we cannot neglect these words . . ."

In the present case the language of the Reading Company certificate is "the First Preferred Stock is entitled to non-cumulative dividends at the rate of, but *not exceeding*, four per cent. per annum. . . ."

If it had been intended that the preferred stock was to be entitled to any share in earnings exceeding 4% and

that the preferred stock was to receive the 4% dividends, only in preference to dividends on the common stock, and that after the 4% dividends on the common stock were paid, the preferred stock was to share with the common stock in further earnings, the purpose would have been clearly and distinctly indicated. The words "*not exceeding four per cent.*" as held in the *Baltimore & Ohio* case limit the rights of the preferred stockholders to 4 per cent. *and no more*. As said by the Court in the *Baltimore & Ohio* case:

"According to the fair meaning of these words, it seems to be clear that a proper construction of them, and the only one that will harmonize them all, is that the preferred stock should be non-cumulative, and should receive 4 per cent. and no more out of net earnings, but should be entitled to receive that before any dividends are set aside for the common stockholders."

In *Stone v. U. S. Envelope Co.* (Maine 1920) 111 Atl. 536, a common stockholder brought a suit to enjoin the carrying into effect of a vote of the Board of Directors to sell certain stock at \$150.00 per share to both common and preferred stockholders. It appeared that the price of \$150.00 per share was materially below the value of the stock sought to be sold. The preferred shares were entitled to cumulative dividends of 7% and were entitled to preference upon distribution of the assets of the corporation in liquidation. The plaintiff contended that the "*sale*" of stock at less than its value, was in effect a dividend and the preferred stockholders were not entitled to receive any of the benefits therefrom. The injunction issued. The Court said, page 537:

"Both parties present authorities sustaining their respective contentions. There are two opposing theories, each of which has judicial support. One theory is that the preferred stockholder presumptively yields nothing in compensation for the benefits

which he receives; that he has and holds all the rights of the common shareholder and in addition has his preferential rights.

"Upon this theory the defendant relies, and in support of it cites *Jones v. Railroad Co.*, 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650 (1892), and a series of cases in Pennsylvania, the latest of which, *Englander v. Osborne*, 261 Pa. 366, 104 Atl. 614, 6 A. L. R. 800, affirms the earlier decisions."

"The other theory, which we believe to be better and supported by the weight of authority, is that, in receiving the greater security of his preferential rights, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation.

"The maxim, '*Expressio unius*', etc., applies to this case and is decisive."

"Independent reasoning as well as what we deem to be the preponderance of authority sustains the plaintiff's position. Words in contracts, as well as in statutes, should ordinarily be construed 'according to the common meaning of the language.' Surely the phrase 'preferred stock' holds out to the ear of the ordinary investor no promise of participation in earnings beyond his preferential dividend. That this is true has been recognized by authorities.

"It is generally assumed that, where preferred shares are given a fixed preferential dividend at a specified rate, that impliedly negatives any right to take any further dividends.' Palmer's Company Precedents (11th Ed.) 814.

"Preferred shares and stock are ordinarily spoken of and regarded, and I think properly regarded, as shares or stock which carry a fixed preferential dividend and are not entitled to anything more.'" *Will v. United Lankat Plantations Co.*, *supra*.

In *Russell v. American Gas & Electric Co.*, 152 App. Div. (N. Y.) 136, the corporation proposed to sell common stock at par to the holders of common stock only.

The market value of the common stock was about \$30.00 above par. A preferred stockholder brought suit to restrain the proposed sale unless he, as a holder of preferred stock, could participate ratably. The Court denied the plaintiff's right to an injunction and said (p. 138) :

"Where a corporation has property in excess of the amount of its capital stock, the excess is surplus which may be divided among the stockholders entitled to share therein, either in money or property. (*Williams v. Western Union Telegraph Co.*, 93 N. Y. 162.) As a holder of the preferred stock the plaintiff could claim no interest in such excess. So long as the dividends upon his stock were paid, and the defendant had property equal in value to the amount of its outstanding capital stock, after the payment of its debts, the corporation, if it saw fit to do so, could distribute all the rest of its assets among the holders of its common stock and the plaintiff would have no ground for complaint.

"It is not claimed that the capital stock of the defendant has been impaired, or that it could not legally issue the additional stock at par. That being so, whatever value the stock had above par represented surplus and was available for distribution among the holders of its common stock."

In *Equitable Life Assurance Society v. Union Pacific R. R. Co.*, 212 N. Y. 360, a preferred stockholder sought to restrain the distribution by the corporation of a large dividend to its common stockholders. The dividend was the result of profit from the sale of securities and from the conversion of bonds into common stock. The preferred stock was entitled to dividends at a rate not exceeding 4% per annum payable out of net profits. The Court denied the injunction.

It is significant that it was conceded that the preferred stockholders received all of the dividends to which they were were entitled under the stock certificates. The preferred stockholders, however, contended that the

money sought to be distributed was an accretion to capital stock in which the preferred stock was entitled to share. As to that contention, the Court says on page 368:

"Ordinarily the profits made by a corporation on the purchase and sale of property would so clearly belong to a fund applicable to the payment of dividends that there would be no debate about it. . . . One item of profit is not to be differentiated from another by the nature of the transaction which produced it The proposition that these profits because resulting from what was perhaps an unusual transaction are not profits, but are an accretion which belongs to capital, does not seem to have any foundation on which to rest except earnest assertion."

In *Niles v. Ludlow Valve Mfg. Co.*, 196 Fed. 994, affd. 202 Fed. 141, the corporation voted a stock dividend to its common stockholders exclusively. The preferred stock was entitled to a fixed dividend of 8% per year. For twenty years dividends of 8% had been declared upon the preferred stock, and almost always at a much higher rate upon the common stock. The preferred stockholders contended that the stock dividend be distributed to preferred stockholders as well as to common stockholders. The Court denied the petition of the preferred stockholders. The Court said on page 143:

"These (common stockholders) have the burden of administration upon them; if the corporation is unsuccessful, the loss falls upon them; if successful, they receive the benefits. We think that when the preferred stockholders receive a large interest of 8% provided for in the certificate, they receive all to which they are entitled from the income of the corporation."

"The common shareholders bear substantially all the losses of adversity and are entitled to the gains of prosperity. A contract that they should assume

all the risk with no corresponding advantage should be clearly established. We find nothing in the law or the certificates or in the past action of the corporation to indicate that the preferred was to share equally with the common in the division of the surplus earnings."

In *Keith v. Carbon Steel Co.* (not reported, but which is set forth in Appendix B hereto) decided by the District Court of the United States for the Western District of Pennsylvania, May Term, 1917, a preferred stockholder, after receiving the full dividends, sought to enjoin the payment of an additional dividend of 2% to the common stock on the ground that the common stock had already received dividends as great as those received by the preferred. The preferred stockholder contended that the preferred stock should share ratably with the common stockholders. But ORR, J., denied the plaintiff's prayer, saying:

"If there were no classification of stock, every share of stock would be entitled to an equal share in the distribution of profits. This proposition is Hornbook Law. The holders of the first preferred stock and the holders of the second preferred stock must be deemed to have been unwilling to take the same risks as the holders of the common stock were willing to take. In other words, they were not willing to take their certificates without an *expression* therein of the amount which they were entitled respectively to receive out of the profits. In their contracts with each other and with the common stockholders, and as well with the corporation, they must be deemed to have insisted upon *expressing* the amount which they should receive out of the net profits. We are unable to see why in contracts such as these before us, the *expression* of the amount to be received under the contract should not be deemed to be an *exclusion* from the minds of the parties for any additional amount. . . .

"A certificate of stock does not ordinarily express the share of profits which a stockholder shall receive from the corporation, and therefore, the law *implies*

a term in the agreement that the holder of such certificates shall share equally in the profits set apart by the management for the payment of dividends. There can be no implication, however, where the contract expressly states the percentage which the one contracting party is to receive from another."

In *Will v. United Lankat Plantations Co.*, 106 L. T. Rep. (N. S.) 531; reversed on appeal in (1912) 2 Ch. 571 and (1914) A. C. 11, the corporation proposed to distribute profits from a sale of a substantial part of the company's property and business among the common stockholders exclusively. The preferred stockholders were entitled to cumulative preferential dividends of 10%. A preferred stockholder sought a declaration that he was entitled to share equally with the common stock in the net profits after both classes of stock had received a dividend of 10%. The lower court decided in favor of the preferred stockholders, but the decision was reversed in the Court of Appeals and the latter decision was affirmed by the House of Lords. In the Court of Appeals, FARWELL, J., says (1912) 2 Ch. 571, 579:

"They (the preferred stockholders) treat shares as though they were born into the world equal, and as if a preference is a kind of subsequent attachment to them, but the whole of the attributes of a preferred share are limited and defined on its birth."

In the House of Lords (1914) A. C. 11, 19, Lord Loreburn says:

"My lords, I have no doubt myself in regard to this particular resolution, that the people who took the preference shares under it knew perfectly well that they were taking shares with a preferential dividend of 10%. I think they would have been rather surprised, although no doubt they would have been gratified, if they had been told that they were about to receive the almost boundless additional advantages which have been held out to them in the arguments we have been hearing. This is really an attempt to add to the terms of the contract by screwing some-

thing out of the articles which the framers of the contract I do not believe ever thought of; at all events they have stated their contract. It speaks for itself upon this particular subject and ought not to be added to."

9. The decisions of the Pennsylvania State Courts are Distinguishable.

The preferred stockholders cite various decisions of the Supreme Court of Pennsylvania including

Englander v. Osborne, 261 Pa. 366, 104 Atl. 614 (1918);

Sterling v. H. F. Watson Company, 241 Pa. 105, 88 Atl. 297 (1913);

Sternbergh v. Brock, 225 Pa. 279, 74 Atl. 166 (1909);

Fidelity Trust Company v. Lehigh Valley Railroad Company, 215 Pa. 610, 64 Atl. 829 (1906).

The Pennsylvania cases may be taken as favoring the principle that in the absence of any words of limitation in the certificates, when earnings are in excess of the amount of the dividend to the preferred shareholders, the common stockholders thereafter are entitled to a like dividend and, thereafter, both preferred and common stockholders are entitled to the excess ratably. This doctrine applies, however, only when the preferred stockholders' certificates simply state the preference and contain no words of limitation that the dividend shall be restricted to the amount of the preference.

The Pennsylvania cases are wholly inapplicable to the situation in the case at bar; for the stock certificates constituting the basic agreement in the case at bar plainly state that preferred shareholders shall be entitled to non-cumulative dividends at the rate of, *but not exceeding*, 4

per cent. per annum. *This language has never been construed by any Pennsylvania case.*

Furthermore, in none of the Pennsylvania cases was there a continuous uniform practical construction of the contract by the parties, as in the case at bar, to the effect that the preferred was strictly limited to the fixed dividend rate and the common entitled to dividends in excess thereof. Indeed, the Court in *Sternberg v. Brock* (*supra*), is careful to point out that there was no such conduct by the parties.

Again, the Pennsylvania courts do not deal with that provision in the certificates in the case at bar, which is of high importance, to the effect that the preferred may be redeemed at par.

The Pennsylvania cases, therefore, are wholly inapplicable to the facts herein. We go further. We submit that the Pennsylvania doctrine is unsound and that the Federal Courts should refuse to follow it.

10. The construction of the stock certificates should be governed not by any peculiar doctrine of Pennsylvania law, but by the general principles of commercial jurisprudence.

Stock certificates, preferred and common, are sold in vast volume throughout the United States.

The term "preferred stock" has acquired a well defined meaning. The Court in the *Stone* case based its decision largely on "the common meaning of the language". It would be most unfortunate for preferred stock to mean one thing in one jurisdiction and another thing in another.

The Federal courts are not bound to follow the decisions of the Pennsylvania courts in the matter at issue in this case, and it will undoubtedly be noted that the issuance of the stock of the Reading Company antedated the Pennsylvania decisions.

In *Kuhn v. Fairmont Coal Co.*, 215 U. S. 349, the question was as to the construction of a mine lease. MR.

JUSTICE HARLAN fully reviewed the entire subject, saying among other things:

“(p. 360) : We take it, then, that it is no longer to be questioned that the Federal courts in determining cases before them are to be guided by the following rules: 1. When administering state laws and determining rights accruing under those laws the jurisdiction of the Federal court is an independent one, not subordinate to but coordinate and concurrent with the jurisdiction of the state courts. 2. Where, *before the rights of the parties accrued*, certain rules relating to real estate have been so established by state decisions as to become rules of property and action in the State, those rules are accepted by the Federal court as authoritative declarations of the law of the State. 3. *But where the law of the State has not been thus settled*, it is not only the right but the duty of the Federal court to exercise its own judgment as it also always does when the case before it depends upon the doctrines of commercial law and general jurisprudence. 4. So, when contracts and transactions are entered into and rights have accrued under a particular state of the local decisions, *or when there has been no decision by the state court on the particular question involved*, then the Federal courts properly claim the right to give effect to their own judgment as to what is the law of the state applicable to the case, even where a different view has been expressed by the state court after the rights of parties accrued. But even in such cases, for the sake of comity and to avoid confusion, the Federal court should always lean to an agreement with the state court if the question is balanced with doubt.

The court took care, in *Burgess v. Seligman*, to say that the Federal court would not only fail in its duty, but would defeat the object for which the national courts were given jurisdiction of controversies between citizens of different States, if, while leaning to an agreement with the state court, it did not exercise an independent judgment in cases involving principles not settled by previous adjudications.

It would seem that according to those principles,

now firmly established, the duty was upon the Federal court, in the present case, to exercise its independent judgment as to what were the relative rights and obligations of the parties under their written contract."

See also *Beutler v. Grand Junction R. R. Co.*, 224 U. S. 85, 88.

The construction of the stock certificates may be said to be analogous to the construction of a will or of a deed. This Court has refused to follow decisions of state courts on the construction of a will (*Lane v. Vick*, 3 How. U. S. 464) and of a deed (*Foxcroft v. Mallett*, 4 How. U. S. 353, 379).

The matter of construction of stock certificates, however, is not simply one where this Court may not follow the decision of state courts, but according to principles early laid down, the Court has an affirmative duty to exercise its independent judgment.

In *Swift v. Tyson*, 16 Pet. 1, it was established that with reference to commercial documents, the true interpretation and effect is not to be found in any decisions of any particular state but in the general principles and doctrines of commercial jurisprudence. The doctrine of *Swift v. Tyson* has never been departed from and has always been regarded as following one of the principles upon which the jurisdiction of the Federal courts rests. The actual case was one involving a bill of exchange drawn in one state and accepted in another. The classic language of the court in *Swift v. Tyson* was that the Federal courts in construing contracts and other instruments of a commercial nature would follow "the general principles and doctrines of commercial jurisprudence".

The doctrine has been followed in the case of insurance contracts.

Carpenter v. Providence Washington Insurance Company, 16 Pet. 495, 511;

Aetna Life Insurance Co. v. Moore, 231 U. S. 543.

It has also been applied to a case of stockholders' liability where a Missouri court construed the Missouri statute one way and this court construed it in another way (*Burgess v. Seligman*, 107 U. S. 20) and to a similar case in *Clark v. Bever*, 139 U. S. 96. In the latter case, stock of an Iowa railway company was issued to a construction company. A judgment creditor of the railway company sought to hold the stockholder on the theory that the stock was not fully paid. An Iowa Statute and the decisions of the highest Iowa court recognized the liability. This Court held the stockholder was not liable and stated:

"We cannot consistently with our deliberate judgment upon this question of general law accept the decision of the State Court as controlling the determination of the present case."

A certificate of preferred stock is a commercial document; likewise a certificate of common stock. The words have a generally accepted commercial meaning. As said by the Court in *Stone v. U. S. Envelope Company, supra*.

"Surely the phrase 'preferred stock' holds out to the ear of the ordinary investor no promise of participation in earnings beyond his preferential dividend"; and, quoting from *Will v. United Lankat Plantations Company, supra*,

"Preferential shares of stock are ordinarily spoken of and regarded, and I think properly regarded, as shares or stock which carry a fixed preferential dividend and are not entitled to anything more."

On this point it may not be necessary to refer to the decided cases, for the Reading Company seems to admit that the preferred stockholders are limited to 4% dividends. In their answer, they state that though the intervening common stockholders may object to the transaction,

"they cannot have it treated as a profit, entitling them to exclusive participation *as in the case of dividends from current profits in excess of 4%.*" (R. 164, italics ours.)

III.

The Transaction is Not a Sale.

It has none of the elements of a sale. There has been no attempt to realize the value of the property to be disposed of. There is to be no auction, no offer to the public. The general public is prevented from bidding either for all or any part of the New Coal Company stock. The disparity between the alleged "price" and the value of the New Coal Company stock is too great. The alleged consideration is purely formal. Rather than a consideration for a sale, it is an assessment on a dividend.

We need merely examine the condition of the Coal Company after the payment to the Reading Company of \$10,000,000 in cash or current assets at market value, and the delivery of a mortgage for \$25,000,000, to conclude that no adequate consideration will be received by the Reading Company for the transfer of the shares of stock of the New Coal Company.

The Coal Company owns or controls more than 45% of the unmined anthracite coal deposits in the United States (R. 6, 262). In addition to an interest in these coal properties (valued on the books of the Company as of December 31, 1920, at \$43,183,094.88), the stock of the New Coal Company will represent an interest in improvements and equipment valued at \$14,894,210.91, and stocks and bonds of, and loans to, controlled companies valued at \$9,920,260.85 (R. 198). After the payment of the \$10,000,000 in cash or current assets provided by the plan, the remaining current assets and Liberty Bonds owned by the Coal Company alone will aggregate \$25,450,372.21. Against all this, the only substantial obligations of the New Coal Company will be some \$6,000,000 in current liabilities and the proposed new mortgage of \$25,000,000.

To contend that the stock of the New Coal Company is worth no more than \$4 a share, is to assert that the value of 45% of the unmined anthracite coal deposits in the United States, the improvements made by the Coal Company thereon, and the stocks and bonds of, and loans to, the controlled companies of the Coal Company (subject to an indebtedness of some \$6,000,000) are worth in the aggregate no more than \$5,600,000.* So to contend is also the equivalent of an assertion that the stock of a company whose earnings for the year 1920 alone aggregated \$6,672,222 (R.198) (and against these earnings \$1,000,000 represents the maximum fixed charges upon the property when the new mortgage of \$25,000,000 is delivered) and whose earnings for the four preceding years were \$2,463,790 (1916), \$5,436,633 (1917), \$4,160,162 (1918), and \$2,866,736 (1919) respectively, is worth no more than \$5,600,000 (*supra*, pp. 7, 8).

The Coal Company never paid a dividend on its stock to the Reading Company. Its earnings have been permitted to accumulate until the surplus of the Coal Company now amounts to \$25,685,428.48 (R. 198).

The net earnings of the Coal Company for the years 1916 to 1920 (after the deduction of \$1,000,000 in interest payments required to be made upon the \$25,000,000 4% mortgage to be delivered to the Reading Company), if distributed, would be sufficient to pay an average annual dividend of 59% upon the price (\$5,600,000) to be "paid" under the plan for the stock of the New Coal Company. *The earnings for the year 1920 alone (after deducting \$1,000,000 interest on the 4% mortgage) if distributed, would be more than sufficient to pay to the holders of the stock of the New Coal Company a dividend of 100% upon*

* The \$25,000,000 of current assets are set off against the mortgage of \$25,000,000 although exact accounting would require that a long term 4% mortgage bond such as that of the New Coal Company, be valued at 80% of the principal amount when the current rate of interest on such investment is, as it is now, at least 6%.

the "investment" of \$5,600,000, which the plan provides the stockholders should "pay" for the stock of the New Coal Company; and the earnings for the four preceding years, if distributed, would be sufficient to pay dividends of 26% (1916), 79% (1917), 56% (1918) and 33% (1919).

We appreciate all of the net earnings could not providently be distributed, those not distributed will be "ploughed back" into the property, which can only enhance its value. We submit that the enormous value of the coal property, and the past large earnings thereon, as compared with the alleged "price" show that no real "sale" is intended, and that the term sale is only used as a cover for something else.

The question is not whether \$4 per share to be "paid" for the stock of the New Coal Company is sufficient in law to support a contract, and we do not understand that any contention is made that property of the Reading Company may be distributed, transferred or sold upon a consideration merely sufficient to support a contract at common law. The question is whether \$5,600,000 measures the value of the property to be transferred, or under the circumstances the method adopted is merely a subterfuge.

The Reading Company alleges in its cross petition that it will receive \$40,600,000 under the proposed plan instead of \$5,600,000 for the sale of its interest in the coal properties (R. 163). None of the \$35,000,000 to be paid to the Reading Company by the Coal Company, however, will come from the transferees of the stock of the New Coal Company. The \$10,000,000 in cash or current assets and the \$25,000,000 in the form of a new mortgage are consideration, not for the transfer of stock, but for the assumption by the Reading Company of all the obligations of the Coal Company under the mortgage and for the release of the debt of the Coal Company to the Reading Company.

Much has been said in this controversy of book values, actual values and book figures, and in an attempt to justify the transaction proposed, the Reading Company has presented groupings of figures and commingling of assets (R. 168-171). The effect of the plan is clear; it cannot be obscured by calling upon the arts of the accountant. Bookkeeping has no magic, it creates no assets; it merely records facts as they exist and all the mergers and the bookkeeping consequent thereon cannot add a single ton of coal to the deposits of the Coal Company nor a single ton of rails to the assets of the Railway Company, nor can it reduce the value of the property which is the subject of the litigation.

Book values of properties made twenty-five years ago, as were the values of the coal properties on the books of the Reading Company, are acceptable at this date if the facts approximate the book values. The actual value of the assets in this case approximates the book value, and this Court is justified in taking the book value as the real worth of the assets.

If what the Reading Company really means when it insists so boldly that the transaction constitutes a sale, is that it is a *bona fide* transaction in which the Reading Company receives as much, or about as much, as the stock is worth (R. 163), and that the transaction is so completely a sale that there is no element in it of benefits conferred by way of dividends to any class of stockholders not entitled thereto, this, as we have seen, is contrary to the plain facts.

No good may be accomplished by calling the transaction one name or another. Suppose it be considered a "sale"; the transactions in the *Stone* and *Russell* cases (*supra*, pp. 23, 24) were so denominated. However denominated, and even for the purpose of argument if it be conceded that some element of sale is involved, the essence of the transaction is that large pecuniary benefits are con-

ferred upon preferred stockholders, to which they are not entitled, in derogation of the rights of common stockholders. This essential nature of the transaction cannot be concealed.

The Union Pacific Case.

The Reading Company relies largely on an alleged precedent in the Union Pacific dissolution. That is no precedent, however, for the proposed transaction. The sale of the stock of the Southern Pacific did not result in the impairment of the surplus of the Union Pacific. No claim could there be made that the transaction there resulted in the distribution of the surplus to which the holders of the common stock alone were entitled. But the real difference between the two cases is that between a *bona fide* sale and that which is not. The consideration for the sale of the Southern Pacific shares in the Union Pacific case was adequate.*

That the decree in the *Union Pacific* case would not have warranted the distribution of Southern Pacific shares at any nominal consideration is abundantly shown by the recital in the decree that the subscription price for Southern Pacific stock could be paid in instalments, but that there must be paid "at the option of the sub-

* In fact the price at which the Southern Pacific shares were offered was approximately the market price of Southern Pacific stock at the time. The final decree in the Union Pacific case was entered June 30, 1913. Holders of record, on August 7, 1913, of Union Pacific stock were given the right to purchase their *pro rata* proportion of Southern Pacific shares at \$92 per share, or \$88 plus accrued dividends. See *N. Y. Commercial & Financial Chronicle* for August 16, 1913. The range of prices for Southern Pacific on the New York Stock Exchange during August, 1913, was from 89% to 94½, or an average of 92-1/16. The range for the last six months of 1913 was from 83 to 95, or an average of 89. The closing quotations for Southern Pacific on the last day of each of the last seven months of 1913, were as follows: 93¼, 91¾, 89⅞, 90⅜, 87, 87¼, and 88¾. The quotations given may be found in the monthly reports of the *N. Y. Commercial & Financial Chronicle* for the year 1913. These facts were stated by intervenors-appellants in their brief in the court below and no objection thereto was made.

scriber \$25 per share at the time of subscription and the balance within one year thereafter, with interest on such balance at the rate of 6% per annum". (Decrees and judgments in Federal Anti-Trust Cases, pp. 20-22.)

On the other hand, the Reading Company cannot well deny that it could sell shares of the New Coal Company many times over if they were offered to the public even at prices substantially above \$4 per share for the new stock.

Nowhere in its cross petition, does the Reading Company allege that \$4 per share is the amount which represents an *adequate* consideration for the sale of a share of stock of the Coal Company, but it alleges "it is a *substantial* not a *nominal consideration* and is in the judgment of the Board of Directors of the Reading Company *adequate for the requirements* of the Reading Company" (R. 163). Does this mean any more than that the sale of the stock at such price will not produce insolvency of the Reading Company or impair its capital stock, and if not, what does it mean? As stockholders, the appellants have the right to have the Reading Company obtain a *quid pro quo* for assets purported to be sold and to demand the judgment of the board of directors, not upon the question of whether the consideration is "*adequate for the requirements of the . . . Company*", but whether the consideration is adequate as a *quid pro quo* for the assets from which the Reading Company is to be separated. The property of the Reading Company is not entrusted to the board of directors for the purpose of enabling them to *parcel it out* in such manner as they deem advisable *without regard to the rights of the stockholders*, and the board of directors cannot under the guise of meeting the "*requirements*" of the Company, give that which belongs to the common stock, to the preferred stock for a consideration, however substantial, which cannot be claimed to represent the true value of the property to be transferred.

There is no discretion in a board of directors which permits them to clothe a dividend with the form of a sale and thus seek to render action, invalid as a declaration of a dividend, valid as a sale. Discretion must be real, not formal, and the fiduciary obligation imposed upon a director is not properly exercised when property which he, as a director for many years, has declared in the balance sheets published broadcast to be of great value, is turned over not to a purchaser dealing at arm's length and in good faith for a much lesser sum, but to any class of stockholders who neither in law nor in equity is entitled to receive the same. To give to one stockholder what is unlawfully taken from another, does not justify denominating a dividend, a sale.

In short the Union Pacific *was* an actual sale, and the proposed Reading transfer *is not*.

But even if the proposed Reading transaction were technically a sale, it is one wholly different from that undertaken in the *Union Pacific* case. The one was a sale which could not be set aside because it was a *bona fide* sale and for an adequate price. The other, if a sale, is one to which objection can properly be made because it is at a wholly inadequate price (a small fraction of the market price even during the present period of financial and commercial depression) and is not a *bona fide* sale, but rather a transaction which in substance contemplates an actual *distribution* to stockholders.

IV.

Assuming, *arguendo*, that the transaction is a sale it is void because made by a corporation to its controlling stockholders for inadequate consideration.

We shall assume, to meet opposing contentions, that the proposed transaction is a sale. Nevertheless, we submit that it is legally to be condemned.

1. As fiduciaries, the controlling stockholders have the burden to demonstrate that the sale does not deprive the minority of legal rights, and is fair and for adequate consideration.

The doctrine that the majority holds a fiduciary relationship to the minority is well settled. *Southern Pacific R. R. Co. v. Bogert*, 250 U. S. 483; *Mason v. Pewabic Mining Co.*, 133 U. S. 50; *Wardell v. R. R. Co.*, 103 U. S. 651; *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587; *Backus v. Brooks*, 195 Fed. 452; *Jones v. Missouri Edison Electric Co.*, 144 Fed. 765; *Rothchild v. Memphis & C. R. Co.*, 113 Fed. 4; *Mumford v. Ecuador Development Co.*, 111 Fed. 639; *Rogers v. Nashville C. & St. L. Ry. Co.*, 91 Fed. 299; *Ervin v. Oregon Ry. & Navigation Co.*, 27 Fed. 625; *Mecker v. Winthrop Iron Co.*, 17 Fed. 48.

The doctrine was stated in *Southern Pacific R. Co. v. Bogert*, 250 U. S. 483, as follows:

(p. 487, 488): "The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors."

In *Backus v. Brooks*, 195 Fed. 452, the court phrased it as follows:

(p. 454): "Courts of equity have no more valuable function than to protect minority stockholders from the frauds of the majority. When majority stockholders dispose of the property of the corporation which they control in such a manner as to deprive the minority of their just rights in it, there is a breach of trust, and a court of equity is the tribune and the only tribune to provide an effective remedy. . . .

The rights of minority stockholders are those which it is peculiarly the duty of a court of equity to protect."

In *Mumford v. Ecuador Development Co.*, 111 Fed. 639, majority stockholders transferred valuable assets of

the corporation worth \$6,000,000 to another corporation which the majority owned, for 10% of the future profits of the second corporation. The Court deemed the consideration inadequate, and gave the aggrieved minority stockholders appropriate relief. The Court said:

(p. 643): "Unless it appears that it was made honestly and for an adequate consideration, a court of equity would interpose to prevent such contracts from being used oppressively and in violation of the rights of the minority. It matters not in what form these rights are invaded; it is the business of equity to penetrate through subterfuges and discover the actual transaction stripped of its disguises. If, then, it shall appear, no matter what may be the machinery employed, that the majority have sold the corporate property to themselves for a wholly inadequate consideration, a court of equity will grant relief to the minority who have thus been despoiled of their property."

In *Mason v. Pewabic Mining Co.*, 133 U. S. 50, the majority stockholders of a mining corporation authorized the sale of all its property worth \$500,000 for \$50,000 to a new corporation. The plan provided that the stockholders of the old corporation have the choice of either receiving an equal proportion of stock in the new company or of taking their *pro rata* share of the \$50,000 in cash. The prayer of the plaintiff, a minority stockholder, for an injunction restraining the mining company from transferring its property to the new corporation was granted.

In *Jones v. Missouri Edison Electric Co.*, 144 Fed. 765, a corporation with \$4,000,000 of stock outstanding, one-half preferred and one-half common, had net assets of about \$2,600,000. The majority acquired the entire stock of another corporation whose assets were worth \$600,000. A plan of consolidation was drawn up whereby the preferred stockholders (the minority) of the first corporation

whose interest in the assets was 8/13ths (including the arrears of dividends) of the entire assets of the first corporation and one-half of the total combined assets of both corporations were to own only 5/32nds of the combined assets of both corporations whereas the common stockholders who owned, prior to its consolidation, only $\frac{1}{2}$ were to own 27/32nds. A preferred stockholder complaining of the appropriation of his assets by the majority, was given relief. The Court said, speaking through SANBORN, *C. J.*:

(p. 771): "A combination of the holders of a majority or three-fifths of the stock of a corporation, to elect directors, to dictate their acts and the acts of the corporation for the purpose of carrying out a predetermined plan, places the holders of such stock in the shoes of the corporation and constitutes them actual, if not technical, trustees for the holders of the minority of the stock. The devolution of power imposes correlative duty. In a sale of its property, in a consolidation of a corporation with another, in every act and contract of the corporation, which they cause they make themselves trustees and agents of the holders of the minority of the stock because it is only through them that the latter may act or contract regarding the corporate property or preserve or protect their interests in it. Such a majority of the holders of stock owe to the minority, the duty to exercise good faith, care, and diligence to make the property of the corporation in their charge produce the largest possible amount, to protect the interests of the holders of the minority of the stock, and to secure and deliver to them their just proportion of the income and of the proceeds of the property. Any sale of the corporate property to themselves, any disposition by them of the corporation or of its property to deprive the minority holders of their just share of it, or to get gain for themselves at the expense of the holders of the minority of the stock, becomes a breach of duty and of trust which invokes plenary relief from a court of chancery . . ."

If the doctrine that the majority are *trustees* of the minority is strictly followed, an objecting minority stockholder may set aside any sale from the majority to itself. For it is a well-recognized principle that a purchase of a *trust res* by the trustee may be set aside by the *cestui que trust*, even though there be no fraud, and even though the sale may be fair and for an adequate consideration. *Allen v. Gillette*, 127 U. S. 589, 593; *Hoyt v. Latham*, 143 U. S. 553; *Perry on Trusts*, 6th Edition, Section 129.

Certain it is that the minority stockholder as *cestui que trust* may prevent any proposed sale from the majority to the majority for an inadequate consideration. Great disparity is not required. And the burden is on the controlling stockholders as trustees to show that the consideration is entirely adequate.

In *Meeker v. Winthrop Iron Co.*, 17 Fed. 48, where a lease made by a majority stockholder with a corporation was considered, the Court said:

"The ownership of a majority of the capital stock of a corporation invests the holders thereof with many valuable incidental rights. They may legally control the company's business, prescribe its general policy, make themselves its agents and take reasonable compensation for their services. But, in thus assuming the control they also take upon themselves the correlative duty of diligence and good faith. They cannot lawfully manipulate the company's business in their own interests to the injury of other corporators. Any contract made by them in behalf of their principal with themselves or with another for their personal gain would be voidable at the option of the company. . . . If a majority of stockholders can, in any event and under any circumstances, thus vote away the corporate property to their individual uses,—a question that need not be decided in this case,—they could only do so upon the clearest and most satisfactory evidence of good faith, and for an adequate consideration; and the

burden of proof is upon the parties thus acting and claiming the enforcement of such a contract. All doubts in relation to adequacy of consideration and good faith ought to be resolved in favor of the principal."

The rule with reference to the fiduciary relation of majority to minority is like that of director to corporation. Only last term, MR. JUSTICE CLARKE, delivering the opinion in *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, said:

(p. 599): "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and where the fairness of such transaction is challenged, the burden is upon those who would maintain them to show their entire fairness, and where a sale is involved, the full adequacy of the consideration. . . . This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality and, we now add, in the soundest business policy."

The controlling elements, then, are as follows:

(a) There is a body of stockholders which controls the corporation.

(b) Assets of the corporation or part thereof, *i. e.*, the trust *res.* are sold to the controlling stockholders.

(c) Can the controlling stockholders maintain the strict burden of proof upon them to show

- (1) that the consideration is fully adequate; and
- (2) that it is fair to the minority and that the respective rights of the minority are safeguarded?

2. The burden is not sustained by the controlling stockholders in this case.

(a) There is a controlling majority, and this consists of the preferred (*supra*, p. 11). Two stockholders alone, the Baltimore & Ohio Railroad and the New York Central Railroad Companies, whose interests are predominantly as preferred stockholders (*supra*, p. 11), control 1,210,300 shares, or approximately 44% of the entire voting power. As the remaining shares are widely scattered (R. 208-209), this clearly constitutes control. *United States v. Union Pacific Co.*, 226 U. S. 470.

The fact of control by the preferred in the case at bar is emphasized by the presence on the board of directors of at least four direct nominees, Messrs. Willard, Harris, Smith and Bond (*supra*, p. 11), of the two stockholders named, the Baltimore and Ohio and the New York Central Railroad Companies.

(b) The sale is of corporate assets by the majority, to themselves. The answer of the Reading Company admits that the plan was carefully, "anxiously", prepared by the board of directors, who, of course, respond to the controlling majority. And it is clear that the preferred stockholders are to acquire, ex-hypothesis, one-half of the Coal Company stock to be distributed.

(c) It seems quite as clear not only that the burden of showing "full adequacy of the consideration" cannot be sustained by the majority, but also that the consideration is wholly inadequate (*supra*, pp. 60-63). It is also clear that the plan unlawfully deprives minority stockholders of their legal rights.

Brief notice may be given to a minor contention made in the court below. It was urged by the Reading Company (R. 164) that if the common stockholders object "to having certificates of interest in the coal property sold to the preferred and common stockholders ratably, the

remedy of the common stockholders is to make a bid or to ask the court to require that the certificates of interest be sold at public sale to the highest bidder". A decisive answer to this contention of the Reading Company is the following language of MR. JUSTICE CLARKE in *Geddes v. Anaconda Copper Mining Co.*, *supra*:

(p. 609) : "But the district court, notwithstanding this finding of inadequacy of price, did not set the sale aside, but ordered that the Alice properties should be offered at public auction by a master, and that if no bid should be received for an amount greater than that which the Anaconda Company had agreed to pay, the sale should be confirmed. The offer at public sale was made, no bid was received, and the private sale to the Anaconda Company was thereupon confirmed. . . .

"In this case, from evidence as to the character of the Alice properties, their location and surroundings, and from the opinions of experts, the trial court concluded that the price paid for them was inadequate, and we cannot doubt that from like or other evidence a more trustworthy conclusion could be obtained as to what their value was than would be derived from an offer at a public sale for cash. . . .

" . . . and when the price was found to be inadequate, a decree should have been entered, vacating and setting it aside, as prayed for by the appellants."

But, say the preferred stockholders, the minority are only entitled to share in the "fruits of the sale" (*Southern Pacific Co. v. Bogert*, 250 U. S. 488), and if any improper benefits accrue, the common shareholder cannot object for he participates equally. "Equality is equity", say the preferred shareholders.

An unlawful transaction is not purged of illegality because the person injured is offered equal participation in the fruits thereof.

In the case of *Mason v. Pewabic Mining Co.* (*supra*, p. 68), it was held no answer to the objecting minority stockholders that they were permitted to share equally in the stock of the new corporation.

The rule, moreover, is not that the minority share in the fruits of the sale and share equally; but that they participate fairly in accordance with their legal rights on the facts in each case. In the present case, since the "sale" of the Coal Company leaves the capital of the Reading Company unimpaired, any "fruits" thereof must go to the common. The preferred is limited to benefits at "not exceeding 4% per annum". If there be any participation in further benefits, it must be among the body of common stockholders alone.

The preferred stockholders if paid their 4% dividends can have no interest in surplus remaining. All such surplus is in equity the property solely of the common stockholders. The majority in the instant case propose to distribute such surplus partly to themselves. Their argument that "equality is equity" is the argument of him who hath no rights to him who hath all—"share equally with me, for equality is equity". Equity seeks justice, however, and justice as administered by the courts requires that the legal rights of parties be enforced.

When all argument appears to fail, the preferred stockholders resort to the maxim that "equality is equity". But equality is equity only where equality is right. Thus in the distribution of the assets of an insolvent, where the right to share is conceded but the extent thereof presents an insoluble problem, justice is achieved by according equality to different classes of creditors. But the Reading Company is not an insolvent and the right of the preferred stock to share in accumulated earnings for years in which the preferred stock received "full" dividends, does not exist.

The unfairness of the proposed sale is further shown by analysis of the position of the preferred and common stock after its consummation. Prior thereto, preferred stock clearly cannot participate in current profits of the Coal business in excess of 4% per annum. Thereafter, the preferred stock, by reason of joint ownership in

one-half the Coal properties and business, participate with the common stock without limit as fully equal owners of the no par value New Coal Company stock.

It may be rejoined that this is a recurrence to arguments already considered, *i. e.*, Points I and II, *supra*. It is not so, however. We now consider the question on the assumption that the transaction is a sale. The preferred contend that all facts and arguments with reference to the rights of the parties under the stock certificates, and with reference to dividends is immaterial, because, they say, the transaction is a sale. We answer that as a sale, the transaction is improper and voidable, because as such, it is an attempt by fiduciaries to obtain an unlawful profit for themselves at the expense of the minority which they cannot accomplish when considered under any other guise.

Furthermore, as has previously been pointed out, even if in the transaction in question, there is involved some element of sale this does not negative the contention of the common stockholders that the transaction in essence is a distribution of large pecuniary benefits to preferred stockholders to which they are not entitled.

V.

The transaction is not a distribution from capital.

The Court below said:

"Seeing, then, that this stock . . . is a part of its capital disposed of in this case to qualifying shareholders . . . it will be apparent that this decree of equal right to all shareholders, is based, etc. (R. 282)."

The holding concurred with the contention submitted in the answer of the Reading Company that

"the thing to be sold, the stock of the Coal Company, is a capital asset" (R. 164),

and that the preferred stockholders

“are subject to no limitation with respect to distribution either of capital or of accumulations of profits which for any reason have become part of the capital or partake of the nature of capital” (R. 174).

The Pennsylvania Laws provide that dividends may not be declared out of capital as follows:

Act of May 23, 1913, Section 1, P. L. (1913), 336:

“All corporations, heretofore or hereafter incorporated under any special or general law of this Commonwealth may, at any time or times, declare dividends of so much of their net proceeds as shall appear advisable to the directors; such dividends to be paid to the stockholders or their legal representatives at such time after their declaration as the directors may fix; but such dividends shall in no case exceed the amount of the net proceeds actually acquired by the company, so that the capital stock shall never be impaired thereby.”

See also Act of April 29, 1874, Section 16, P. L. (1874) 81.

The directors of the Reading Company do not intend to violate the Pennsylvania statutes. There is in fact no distribution of capital. It should be sufficient, to dispose of this matter, to refer to the consolidated balance sheet submitted by the President of the Reading Company, showing that if the transactions originally contemplated by the plan had been fully consummated on December 31, 1920, the corporate surplus of the Reading Company would have been \$54,115,478.43 (R. 200).

If it be Assumed, Arguendo, that Distribution from Capital be Involved, the Transaction is Illegal.

If the transaction involves distribution of capital, the capital stock must be correspondingly reduced. The plan provides for no reduction of the capital stock issued.

Either the transaction does not involve impairment of capital, in which case it is idle to consider the rules of law governing a distribution of capital; or, it does involve impairment of capital, in which case it must be disapproved for that reason.

VI.

The transaction is not a distribution by way of dissolution or liquidation.

Nothing can be more clear than that neither the Reading Company nor the Coal Company is being dissolved. Both companies continue in existence—both companies continue to function.

In *Thcis v. Spokane Falls Gas Light Co.*, 34 Wash. 23, the majority stockholders voted to dissolve the corporation, when a minority stockholder refused to sell his stock to an eastern syndicate. The corporation then voted to sell its entire plant to a new gas company newly incorporated for the purpose. In granting relief, the Court said:

(p. 30): "A dissolution of a corporation within the contemplation of the law is the death of the corporation. It means disintegration, a separation, a going out of business. But in this case, all the elements of dissolution are wanting."

See also: *Willard v. Spartansburg R. R. Co.*, 124 Fed. 796; *Swan Land & Cattle Co. Ltd. v. Frank*, 39 Fed. 456; *Brock v. Poor*, 216 N. Y. 387.

Pritchard v. Barnes, 101 Wis. 86 (holding that even though a corporation ceases to function, has no property, and goes into voluntary liquidation, it is not necessarily dissolved). *Parker v. Bethel Hotel Co.*, 96 Tenn. 252; *Harton v. Johnston*, 166 Ala. 317.

This court did not order the Reading Company either liquidated or dissolved. It did order the unlawful combination to be dissolved. It decreed a segregation or separation of the elements, the combination of which was not in harmony with the law. Separation, however, of ownership and control of the Coal Company from ownership and control of the Railway Company and of the Reading Company involves neither dissolution nor liquidation of any of the companies.

Something has been said by opposing counsel of partial liquidation. Such terminology, however, cannot cover up a dividend distribution. Every time a dividend is paid to stockholders, there is a "partial liquidation". The principles which apply in such cases are those which apply to dividends and not to liquidation as upon dissolution of a corporation.

There is, however, not even partial liquidation. The Railway Company continues to do business. The Reading Company, instead of being a mere holding company, becomes an actual operating company. The Coal Company, it is hoped, is to become an active operating company, no longer subject to the domination of the directors of the Reading Company.

Conclusion.

The decree of the District Court should be reversed and the cause remanded with directions to enter a decree in conformity with the law and equity of the case.

ALFRED A. COOK,
Attorney for Appellants.

ALFRED A. COOK,
FREDERICK F. GREENMAN,
ROBERT SZOLD,
of Counsel.

APPENDIX A.

FIRST PREFERRED STOCK

100		100
SHARES		SHARES
NUMBER		SHARES
		100

READING COMPANY

TOTAL PRESENT ISSUE OF FIRST PREFERRED STOCK,
\$28,000,000.

THIS IS TO CERTIFY, That the owner of ONE HUNDRED fully-paid and non-assessable shares, of the par value of Fifty Dollars each, of the FIRST PREFERRED CAPITAL STOCK of the READING COMPANY, transferable only in person, or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment

of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock. Such First Preferred Stock is authorized to the amount of Twenty-eight Million Dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, as well as to the creation of any mortgage additional to that for \$135,000,000 heretofore authorized, except that, at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased, without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and, accordingly, this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may so increase and issue its First Preferred Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant Secretary, of the Reading Company, nor until registered by the Registrar of Transfers in Philadelphia or New York. This certificate is transferable either in Philadelphia or New York.

IN WITNESS WHEREOF, the said Company has caused
this certificate to be signed and the corporate seal to be
affixed hereto, this day of

.....
VICE-PRESIDENT.

.....
ASST. SECRETARY.

ENTERED

.....
TRANSFER AGENT.

REGISTERED IN PHILADELPHIA
PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND
GRANTING ANNUITIES,

REGISTRAR OF TRANSFERS
By

.....
REGISTRAR

Shares \$50 Each

SECOND PREFERRED STOCK

100
SHARES-100
SHARES

NUMBER

SHARES
100

READING COMPANY

TOTAL PRESENT ISSUE OF SECOND PREFERRED STOCK,
\$42,000,000.

THIS IS TO CERTIFY, That the owner of ONE HUNDRED fully-paid and non-assessable shares, of the par value of Fifty Dollars each, in the SECOND PREFERRED CAPITAL STOCK of the READING COMPANY, transferable only in person, or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. The Second Preferred Stock is entitled to non-cumulative dividends, at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such

other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock. Such Second Preferred Stock is authorized to the amount of Forty-two Million Dollars; and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, or of the First Preferred Stock, as well as to the creation of any mortgage additional to the mortgage of \$135,000,000 heretofore authorized. The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of four per cent. per annum shall have been paid for two successive years on the First Preferred Stock, the Reading Company, without further consent from the holder or owner hereof, may exercise the right to convert the Second Preferred Stock, not exceeding \$42,000,000 at par, one-half into First Preferred Stock and one-half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding according to the preferences thereof. This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant-Secretary, of the Reading Company, nor until registered by the Registrar of Transfers in Philadelphia or New York. This certificate is transferable either in Philadelphia or New York.

IN WITNESS WHEREOF, the said Company has caused
this certificate to be signed and the corporate seal to be
affixed hereto, this day of

.....
VICE-PRESIDENT.

.....
ASST. SECRETARY.

ENTERED

.....
TRANSFER AGENT.

REGISTERED IN PHILADELPHIA

PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND
GRANTING ANNUITIES,

REGISTRAR OF TRANSFERS

By

.....
REGISTRAR

Shares \$50 Each

COMMON STOCK

100		100
SHARES		SHARES
	NUMBER	SHARES
		100

READING COMPANY.

TOTAL PRESENT ISSUE OF COMMON STOCK, \$70,000,000.

THIS IS TO CERTIFY, That the owner of ONE HUNDRED fully-paid and non-assessable shares, of the par value of Fifty Dollars each, in the COMMON CAPITAL STOCK of the READING COMPANY, transferable only in person, or by attorney, on the books of the Company in Philadelphia or New York upon surrender of this certificate. First Preferred Stock has been authorized to the amount of Twenty-eight Million Dollars, and Second Preferred Stock to the amount of Forty-two Million Dollars; and a Mortgage has been authorized to the amount of \$135,000,000, and the consent of the holders of at least a majority of such part of the Common Stock as shall be represented at a meeting of stockholders called for that purpose is necessary to any increase of such authorized amount of First Preferred Stock or Second Preferred Stock, as well as to the creation of any additional mortgage; provided, that without further consent, at any time after dividends at the rate of four per cent. per annum shall have been paid on the First Preferred Stock for two successive years, the Second Preferred Stock, not exceeding \$42,000,000, may be converted at par, one-half into First Preferred Stock, and one-half into Common Stock, and that for such purpose and to such extent the Reading Company may increase and issue its First Preferred Stock and its Common Stock. The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law. The Common Stock is subject to the prior rights of holders of all classes of Preferred Stock at any time outstanding, according to the

preferences thereof. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock. This certificate shall not be valid until signed by the President, or one of the Vice-Presidents, and the Secretary, or Assistant Secretary, of the Reading Company, nor until countersigned by the Transfer Agent and the Registrar. This certificate is transferable either in Philadelphia or New York.

IN WITNESS WHEREOF, the said Company has caused this certificate to be signed, and the corporate seal to be affixed hereto, this day of

.....
VICE-PRESIDENT.

.....
ASST. SECRETARY.

COUNTERSIGNED

.....
TRANSFER AGENT.

REGISTERED

PENNSYLVANIA COMPANY FOR INSURANCES ON LIVES AND
GRANTING ANNUITIES,

REGISTRAR OF TRANSFERS

By

.....
REGISTRAR

Shares \$50 Each

APPENDIX B.

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

HENRIETTA S. KEITH, a citizen of the
State of Pennsylvania,
Plaintiff,

AGAINST

CARBON STEEL COMPANY, a corporation
of the State of West Virginia, a citi-
zen of said State.

No. 134,
May Term, 1917.
In Equity.

Opinion.

ORB, J.

Plaintiff seeks to restrain the defendant from the payment of a two per cent. dividend to common stockholders. She is the owner of 244 shares of the second preferred stock of the corporation, and by reason of such ownership, she claims to share in the dividend intended to be distributed to the common stockholders.

The defendant corporation is a corporation of the State of West Virginia, was organized in said State on the 9th day of October, 1894, and has its principal office and its only office for the transaction of its business, in the City of Pittsburgh, in this district. It has fully paid up and issued capital stock of \$5,000,000. face value divided into 50,000 shares of \$100. each, of which 5,000 shares are known as first preferred stock, 15,000 shares as second preferred stock and 30,000 shares as common

stock. Because of this classification of the stock, there must exist certain contractual relationships between the different classes of stockholders of the corporation, so far as the rights of the owners to participate in the profits of the corporation are considered. What such contractual relationships are, we would ordinarily expect to find disclosed in the corporation laws of West Virginia, in the corporate action of the Company and in the certificates issued by the Company to its respective shareholders. The Corporation Laws of West Virginia are not specially helpful. So far as they have been brought to the attention of the Court, the only provision in the laws of West Virginia relating to the subject of the classification of stock, is found in Chapter 53, Section 16 of the West Virginia Code, which is as follows:

“The stockholders in general meeting may, by resolution, or by-law, provide for or authorize the issuing of preferred stock, on such terms and conditions, and with such regulations respecting the preference to be given to such stock over the other stock in relation to future dividends or otherwise, as they may deem proper, *Provided*, That the maximum capital of the corporation shall not be exceeded and that notice be first published at least once a week for four weeks successively in some newspaper of general circulation in the county wherein the principal office or place of business of the corporation is situated, of the intention to offer such resolution or by-law.”

In pursuance of the authority in that section of the law, the stockholders in their first general meeting at which all the stockholders were present, adopted the following resolution:

“Whereas this corporation has reserved in its articles of association the right to increase its capital stock from \$10,000, the amount already subscribed, to \$5,000,000.

"Resolved that the capital stock of this corporation be increased \$4,990,000. so that the aggregate amount of stock shall be \$5,000,000. divided into 50,000 shares of \$100. each, of which 5,000 shares shall be first preferred stock entitled to a non-cumulative dividend of 8 per centum per annum, 15,000 shares shall be second preferred stock entitled to a non-cumulative dividend of 6 per centum per annum, and 30,000 shall be common stock, which stock shall be issued on such terms and conditions as the directors of this Company shall direct. And inasmuch as all the stockholders of said corporation are now present, the publication of notice once a week for four successive weeks of an intention to offer a resolution for the increase of the capital stock of this corporation, as provided in Section 16, Chapter 53 of the Code of West Virginia, is hereby waived."

The certificates of stock which were issued in pursuance of said act and said resolution to the several classes of stockholders were as follows respectively:

"FIRST PREFERRED STOCK.

Incorporated under the Laws of West Virginia.

No. Shares.

CARBON STEEL COMPANY

First Preferred Eight Per Cent. Stock

\$500,000. Shares \$100. each.

This is to certify that
is entitled to shares of \$100 each in the capital stock of the Carbon Steel Company denominated 'First Preferred Stock'. Said stock is entitled to dividends at the rate of eight per cent. per annum payable semi-annually, out of the net profits of the company. The said stock is transferable only on the books of the said company by the stockholders in person or by attorney on the surrender of this certificate.

IN WITNESS WHEREOF, the said company has caused this certificate to be signed by its President and Secretary.

"SECOND PREFERRED STOCK.

Incorporated under the Laws of West Virginia.

No..... Shares.....

CARBON STEEL COMPANY

Second Preferred Six Per Cent. Stock \$1,500,000

Shares \$100. each.

This is to certify that
 is entitled to shares of \$100. each in the
 capital stock of the Carbon Steel Company denomi-
 nated 'Second Preferred Stock'. The said stock is
 entitled to dividends at the rate of six per cent. per
 annum, payable annually out of the net profits of the
 company. The said stock is transferable only on the
 books of the said company by the stockholders in
 person or by attorney on the surrender of this cer-
 tificate.

IN WITNESS WHEREOF, the said company has
 caused this certificate to be signed by its President
 and Secretary.

"COMMON STOCK

Incorporated under the Laws of West Virginia

No..... Shares.....

CARBON STEEL COMPANY

Common Stock \$3,000,000.

Shares \$100. each.

This is to certify that
 is entitled to shares of the common
 stock of the Carbon Steel Company, transferable only
 on the books of the company in person or by attorney
 on the surrender of this certificate."

It will be noticed that by the certificate for the first
 preferred stock, the stockholder is entitled to "dividends
 at the rate of 8 per cent. per annum payable semi-annu-
 ally, out of the net profits of the company", and for the
 second preferred stock that the stockholder is entitled to
 "dividends at the rate of six per cent. per annum payable
 annually out of the net profits of the company".

The contention of the plaintiff is that inasmuch as the common stockholders have already, for the current year, received as large a dividend per share upon the stock held by them as the second preferred stockholders have received, that the corporation must distribute all other earnings for the year which are deemed to be payable to stockholders, to the holders of the second preferred as well as to the holders of the common stock, ratably share for share.

The position of the defendant and certain of the common stockholders who have intervened is that inasmuch as the holders of second preferred stock have received six per centum out of the net profits of the company, that they are not entitled to any more for that particular year, but that all profits for that year distributed in dividends in excess of the amounts specified as payable to the first preferred and second preferred stockholders are properly distributable to the holders of the common stock.

We are of the opinion that the contention of the defendant is sound.

If there were no classification of stock, every share of stock would be entitled to an equal share in the distribution of profits. This proposition is Hornbook Law. The holders of the first preferred stock and the holders of the second preferred stock must be deemed to have been unwilling to take the same risks as the holders of the common stock were willing to take. In other words, they were not willing to take their certificates without an *expression* therein of the amount which they were entitled respectively to receive out of the profits. In their contracts with each other and with the common stockholders, and as well with the corporation, they must be deemed to have insisted upon *expressing* the amount which they should receive out of the net profits. We are unable to see why in contracts such as these before us, the *expression* of the amount to be received under the contract should not be deemed to be an *exclusion* from the

minds of the parties for any additional amount. A contract between a corporation and its stockholders is not any more sacred than a contract between any other contractual parties. Where the parties remain silent in some respects, the law may imply many provisions as intended by the parties. A certificate of stock does not ordinarily express the share of profits which a stockholder shall receive from the corporation, and therefore, the law *implies* a term in the agreement that the holder of such certificates shall share equally in the profits set apart by the management for the payment of dividends. There can be no implication, however, where the contract expressly states the percentage which the one contracting party is to receive from another. We recognize that a somewhat similar case in which a different conclusion was reached was before the Supreme Court of Pennsylvania in *Sternberg vs. Brock*, 225 Pa. 279, and have felt some hesitation in reaching the conclusion herein expressed. The position, however, taken by this Court, is that taken by the United States Circuit Court of Appeals of the Second Circuit in *Niles vs. Ludlow Valve Manufacturing Co.*, 202 Fed. Rep. 141, and if we doubted the correctness of our own conclusions, comity would suggest the propriety of following that decision. The case of *Scott vs. B. & O. R. R. Co.*, 93 Maryland, 475, is helpful, and also the English case of *Will vs. United Lankat Plantations Co.*, reported in the Court below in 106 Law Times Rep. 531, in the Court of Appeals in 107 Law Times Rep. 360, and the House of Lords in 83 Law Journal Chanc. 195 (1914).

Without commenting upon other matters raised by the defendant in opposition to the motion for an injunction, some of which are interesting and may be sound, we content ourselves with the foregoing limited expression of our views on the main question.

The motion for a preliminary injunction must be refused.

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IN THE
Supreme Court of the United States.

OCTOBER TERM, 1921.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCK-
NER and JOHN H. MASON, as a Com-
mittee, etc.,

Appellants,

vs.

READING COMPANY, *et al.*,

Appellees.

BRIEF FOR APPELLANTS.

Statement of the Case.

This is an appeal from a decree (Transcript of Record, p. 287) of the District Court of the United States for the Eastern District of Pennsylvania, filed June 6, 1921, in the cause entitled "The United States of America, Petitioner, *vs.* Reading Company, *et al.*, Defendants." The appellants Seward Prosser, Mortimer N. Buckner and John H. Mason are a Committee representing holders of common stock of defendant Reading Company, and, as such Committee, became intervening parties defendant in

the aforesaid cause under the circumstances hereinafter set forth.

The capital stock of Reading Company consists of

560,000 shares of First Preferred Stock of par value of	\$28,000,000
840,000 shares of Second Preferred Stock of a par value of	42,000,000
1,400,000 shares of Common Stock of a par value of	70,000,000

aggregating 2,800,000 shares of a par value of \$50 each and a total par value of \$140,000,000 (Transcript, pp. 102, 157).

The New York Central Railroad Company, one of the appellees herein, is the owner of 121,300 shares of First Preferred, 285,300 shares of Second Preferred, and 197,050 shares of Common stock (Transcript, p. 140), and The Baltimore and Ohio Railroad Company, another of the appellees herein, is the owner of 121,300 shares of First Preferred, 285,300 shares of Second Preferred, and 200,050 shares of Common stock (Transcript, p. 142). Thus their combined ownerships aggregate,

813,200 shares, or 58% of the 1,400,000 shares of the Preferred stocks,
397,100 shares, or 28% of the 1,400,000 shares of the Common stock, and
1,210,300 shares, or 43% of the 2,800,000 shares of stock of all classes;

and their interests in the Preferred stocks aggregate more than twice their interests in the Common stock.

The appellants represent 2,629 holders of 407,728 shares of the Common stock. Of these holders 462 own less than 10 shares, 1,362 own less than 25 shares, 1,644 own less than 50 shares, 1,931 own less than 100 shares and 698 own 100 shares or more (Transcript, p. 208). Their holdings constitute 29 per cent. of the total of 1,400,000 shares of Common stock and 41 per cent. of the

1,002,900 shares thereof not owned by the two railroad companies, as aforesaid.

This appeal brings up for determination the respective rights of the holders of the Preferred stocks and the holders of the Common stock of Reading Company in and to the interest of the Reading Company in The Philadelphia & Reading Coal & Iron Company upon the disposition of such interest by Reading Company pursuant to the mandate (Transcript, p. 27) of this Court filed in the District Court ~~of~~ in the cause entitled "The United States of America, Petitioner, *vs.* Reading Company, *et al.*, Defendants." At the conclusion of the further proceedings upon said mandate in the District Court a final decree (Transcript, p. 287) was filed therein on June 6, 1921, and from that decree this appeal is taken.

The parties to this appeal, their relations to the subject-matter thereof and to each other, the questions involved therein and the manner in which they are raised, will appear from the following chronological account of the proceedings that resulted in the final decree from which this appeal is taken.

The Segregation Proceedings.

The cause entitled "The United States of America, Petitioner, *vs.* Reading Company, *et al.*, Defendants" was a suit instituted by the Government in 1913 against the Reading Company and certain affiliated corporations to dissolve the intercorporate relations existing between the corporation defendants, for the reason that through such relations they constituted a combination in restraint of interstate commerce in anthracite coal, and an attempt to monopolize or a monopolization of such trade and commerce, in violation of the first and second sections of the Anti-Trust Act of Congress, of July 2, 1890, Chap. 647, 26 Stat. 209; and also for the reason that the defendants, Philadelphia & Reading Railway Company and Central

Railroad Company of New Jersey were violating the commodities clause of the Act of Congress of June 29, 1906, Chap. 3591, 34 Stat. 585, by transporting over their lines of railroad, in interstate commerce, coal mined or purchased by coal companies with which they were associated by stock ownership. Pursuant to the provisions of the Act of June 25, 1910, Chap. 428, 36 Stat. 854, commonly known as the Expediting Act, the then Attorney-General of the United States certified the general public importance of the controversy, and the cause was thereupon heard by three Circuit Judges of the Third Circuit. The decree was filed on October 28, 1915, appeals wherefrom were taken to this Court by both the Government and by the defendants.

Those appeals were decided by this Court in the October Term, 1919. This Court held, among other things, that the control by Reading Company of The Philadelphia & Reading Coal & Iron Company and the Philadelphia and Reading Railway Company constituted a combination in violation of the Anti-Trust Act of July 2, 1890, as well as of the commodities clause of the Act of June 29, 1906; affirmed in part and reversed in part the decree filed on October 28, 1915, and remanded the cause to the District Court with direction to enter a decree in conformity with the opinion of this Court (*United States v. Reading Company et al.*, 253 U. S. 26; Transcript, p. 1).

Upon the mandate (Transcript, p. 27) of this Court dated June 15, 1920, and filed in the District Court on August 13, 1920, the District Court filed on October 8, 1920, an interlocutory decree (Transcript, p. 31) which provided for the dissolution of the combination declared to be unlawful, by directing that "the defendants shall submit to this Court a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia & Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh

& Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal & Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law" (Transcript, pp. 36, 37).

Pursuant to such direction, the defendants, Reading Company, Philadelphia and Reading Railway Company and The Philadelphia & Reading Coal & Iron Company, submitted to the District Court on February 14, 1921, a Plan (Transcript, p. 40) the proposals of which, so far as they are connected with this appeal, were in substance:

1. The Reading Company would assume the \$96,524,000 General Mortgage 4% bonds, being a joint obligation of Reading Company and The Philadelphia & Reading Coal & Iron Company (hereinafter called the "Coal Company"), and would agree to save the Coal Company and its property harmless therefrom (Transcript, p. 41).

2. The Coal Company would pay to Reading Company \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in 4% mortgage bonds of the Coal Company, to be issued under a new mortgage and to mature on January 1, 1997, the same date as the General Mortgage bonds (Transcript, p. 41).

3. General releases of all claims and liabilities as between Reading Company and the Coal Company, including the claim of approximately \$70,000,000 carried on the books of Reading Company as an

asset and on the books of the Coal Company as a liability, would be exchanged (Transcript, p. 41).

4. The Reading Company would agree that it would obtain the release of the coal property from the lien of the General Mortgage and the discharge of the Coal Company from liability on the General Mortgage bonds, provided such release and discharge could be secured by payment by Reading Company to the bondholders of a premium not exceeding 10% upon the par value of the outstanding General Mortgage bonds (Transcript, pp. 41, 42).

5. It was assumed that the Attorney-General would ask the Court to direct the release of the stock of the Coal Company from the lien of the General Mortgage on such terms as the Court might fix. If practicable, the Coal Company would consolidate with Delaware Coal Company, of which it owns the entire capital stock, and the consolidated company would issue stock without par value to Reading Company. If that were not practicable, a new corporation would be created to acquire from Reading Company the stock of the Coal Company, or the interest of Reading Company therein, and such new corporation would issue no par value stock. The number of shares to be issued of the consolidated Coal Company or such new corporation might be 1,400,000.

Such no par value stock would be sold to the stockholders of Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2 for each share of Reading stock. It was proposed to carry out this sale, in accordance with the precedent established by the Union Pacific-Southern Pacific case, by distributing to Reading stockholders assignable certificates of interest in the Coal Company stock exchangeable for such stock only when accom-

panied by an affidavit that the holder was not the owner of any stock of Reading Company. Any further steps which might be deemed necessary by the Court would be taken to the end that an independent board and management, to be approved by it, would be maintained for the Coal Company so that the independence of this company need not await the necessarily gradual process of the distribution of the stock of the Coal Company among persons not holders of stock in Reading Company (Transcript, pp. 42, 43).

6. The Reading Company would merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company and would subject the Railway property to the direct lien of the General Mortgage. The name of Reading Company, after merger, would not be changed. The Reading Company would accept the Pennsylvania Constitution of 1874, and would proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus, Reading Company would be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company would be terminated (Transcript, pp. 43, 44).*

* Paragraph 7 of said Plan (Transcript, p. 44) dealt with a proposed refunding and improvement mortgage to be executed by Reading Company, and paragraph 8 thereof (Transcript, pp. 44, 45) dealt with the sale of the stock held by Reading Company in The Central Railroad Company of New Jersey and the sale of the stock held by The Central Railroad Company of New Jersey in Lehigh and Wilkes-Barre Coal Company. None of these matters is involved in this appeal.

At the time of the submission of said Plan the Government submitted to the District Court a Counter Proposal (Transcript, p. 45) which dealt only with paragraph 8 of said Plan, and is, therefore, not involved in this appeal.

Upon the submission of said Plan and Counter Proposal, the District Court made an order (Transcript, p. 46), filed on February 14, 1921, which directed that copies thereof be served on Central Union Trust Company of New York, the trustee under the General Mortgage referred to in said Plan, and be filed in the office of the Clerk of the District Court and at the offices of Reading Company in Philadelphia and New York, to be open to the inspection of all stockholders of the defendant companies; and, further, set for March 1, 1921, a hearing at which the Attorney-General and counsel for the defendants would be heard further on the Proposed Plan and in regard to the subject-matter thereof.

Copies of said Plan and Counter Proposal having been served and filed as directed by said order, the Government filed on March 1, 1921, a supplemental bill (Transcript, p. 48) to make Central Union Trust Company of New York a party to the cause, for the reason that said Plan provided, among other things, for the release of the stock of the Coal Company from the lien of the General Mortgage referred to in said Plan, and also for the release of all the property of the Coal Company from the lien of said Mortgage and the assumption of the entire obligation thereof by Reading Company (Transcript, p. 49, par. 5).

Immediately after said Plan and Counter Proposal became open to the inspection of the stockholders of Reading Company, the appellants, at the request of certain holders of common stock of Reading Company, formed themselves into a committee for the purpose of examining said Plan and representing and protecting the interests of such stockholders in connection therewith.

After examining the same the appellants concluded that in the formulation thereof the interests of the holders of common stock of Reading Company had been over-

looked and neglected by the Board of Directors of the Reading Company and that the effect of carrying out such Plan was to distribute to the preferred stockholders, ratably per share with the common stockholders, a surplus of upwards of \$33,000,000 accumulated by Reading Company from the undivided net profits arising from its business, whereas, in fact and in law, and in compliance with the contract between the holders of the first and second preferred stocks and the holders of the common stock, practically all of said surplus belonged, under the circumstances there obtaining, to the holders of common stock, to the exclusion of the holders of both classes of preferred stock. Acting upon this conclusion, they prepared a petition (Transcript, p. 96) for leave to intervene and suggesting modification of the Plan, which was verified February 28, 1921, and an amended and supplemental petition (Transcript, p. 101) for modification of the Plan, which was verified on March 14, 1921, both of which petitions were filed on March 15, 1921.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, holders of common stock of Reading Company, also prepared a petition (Transcript, p. 51) for leave to intervene, verified March 12, 1921, wherein they raised substantially the same objections to said Plan as were raised in the petitions of the appellants.

Frances T. Ingraham and others, owners of common stock of Reading Company, by a petition (Transcript, p. 120), verified March 14, 1921, asked for information from Reading Company as to the value of their interest in the property thereof.

The following parties filed petitions for leave to intervene in support of said Plan :

Adrian Iselin, Robert B. Dodson, Edwin G. Merrill and William A. Law, as a committee representing certain holders of first and second preferred stock of Reading Company (Transcript, p. 131) ;

- William B. Kurtz and Madge Fulton Kurtz, owners of 5,100 shares of second preferred stock of Reading Company (Transcript, p. 143);
- The New York Central Railroad Company, owner of 406,600 shares of first and second preferred stock and 197,050 shares of common stock of Reading Company (Transcript, p. 140);
- The Baltimore and Ohio Railroad Company, owner of 406,600 shares of first and second preferred stock and 200,050 shares of common stock of Reading Company (Transcript, p. 142).

The following parties filed petitions for leave to intervene by reason of their ownership of certain of the General Mortgage bonds referred to in said Plan:

- Penn Mutual Life Insurance Company (Transcript, p. 144);
- The Pennsylvania Company for Insurances on Lives and Granting Annuities (Transcript, p. 146).

The Girard Avenue Title and Trust Company, owner of 900 shares of common stock and of \$15,000 principal amount of said General Mortgage bonds, also filed a petition for leave to intervene (Transcript, p. 145).

Joseph E. Widener filed a petition (Transcript, p. 148) for leave to intervene and to present a separate answer to certain of the intervening petitions and cross petitions that had been filed, in which he set forth that he was a member of the Board of Directors of Reading Company; that, as actual owner and as trustee of the estate of P. A. B. Widener, his father, his combined holdings of common stock of Reading Company were over 100,000 shares; that, as a member of the Board of Directors of Reading Company, he had approved, and still approved, said Plan, and that, while he had originally given to the appellant committee his power of attorney with respect to the common stock of Reading Company held by him, he had felt constrained to with-

draw that power and to support said Plan by reason of his belief that the questions of construction of the contracts between the different classes of stockholders and Reading Company that had been raised were not in any way involved in the proceeding.

Central Union Trust Company of New York, on April 12, 1921, filed its answer (Transcript, p. 150) to the supplemental bill (Transcript, p. 48) of the Government, wherein it prayed that no decree should be entered that would in any wise disturb the General Mortgage referred to in the Plan, or the lien thereof, or any security thereunder, or the security of the holders of bonds secured by said mortgage, as in said mortgage provided, and that any decree entered should recognize the unimpaired validity of said mortgage and the lien and pledge thereby created (Transcript, p. 152).

The defendant Reading Company, on April 5, 1921, filed its answer to intervening petitions and cross petition (Transcript, p. 153), in which it defended said Plan against the objections thereto that had been made in the petitions by these appellants and by Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York.

By an order (Transcript, p. 203), filed April 12, 1921, the District Court gave leave to intervene to all of the parties who had filed the aforesaid petitions, and all of said parties duly filed their appearances (Transcript, p. 207). Such of said parties as appeared in a representative capacity, as a committee or otherwise, also duly filed the certificates required of them by said order as a condition to their intervening (Transcript, p. 208).

By a further order (Transcript, p. 205), filed on April 12, 1921, the District Court, being of opinion that certain matters presented in the petitions of the intervenors in relation to the said Plan should be considered further by the Court only after hearing of the parties of record in

the cause, decreed that on May 2, 1921, it would hear argument upon the following questions:

(1) (a) Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

(2) Whether the stock of the Coal Company should be sold free from the lien of the General Mortgage, or whether a sale of Certificates of Interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

(3) Whether the Reading Company should offer a premium of ten per cent. to the General Mortgage bondholders for release of the Coal Company's property from the lien of the mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause.

After argument of said questions, the defendant Reading Company, pursuant to direction of the Court at the hearing, submitted certain modifications of said Plan (Transcript, p. 210) which were designed to meet only the objections that had been made on the argument by Central Union Trust Company of New York, as Trustee of the General Mortgage referred to in said Plan, and by the intervening holders of bonds secured by said mortgage.

The Plan as modified (Transcript, p. 274) was approved by an opinion (Transcript, p. 278) of the District Court, filed May 21, 1921, and, in conformity with said opinion, a decree (Transcript, p. 287) was filed in the District Court on June 6, 1921. From that decree this appeal is taken (Transcript, pp. 332, 333, 338, 339).

The Reading Company.

The Reading Company was incorporated as "Excelsior Enterprise Company" on May 24, 1871, by a special act of the Legislature of Pennsylvania, which act is set forth in full in the record (Transcript, p. 189).

The act provided that the corporation should have, enjoy and exercise the same rights, powers, privileges, franchises and immunities as were conferred by an act entitled "An Act to incorporate the Pennsylvania Company", approved April 7, 1870, and as were conferred by any then existing supplements to the charter of the Pennsylvania Company (Transcript, p. 190, Section 2).

This has the effect of bringing into the charter of the Reading Company the charter of the Pennsylvania Company, as set forth in the act approved April 7, 1870 (Transcript, pp. 190-196), and an act supplementary thereto approved February 18, 1871 (Transcript, pp. 196, 197).

From these three acts, taken together, it appears that Reading Company has "the power to make purchases and sales of or investments in the bonds and securities of other companies, and to make advances of money and of credit to other companies, * * * and to receive and hold, on deposit or as collateral, or otherwise, any estate or property, real or personal, including the notes, obligations and accounts of individuals and companies, and the same to purchase, collect, adjust and settle, and also to pledge, sell and dispose thereof, on such terms as may be agreed on between them and the parties contracting

with them" (Transcript, p. 192), and that there is no limitation upon its corporate powers except that "nothing herein contained shall be so construed as to give to the said corporation any banking privileges or franchises, or the privileges of issuing their obligations as money" (Transcript, p. 191).

This charter does not set forth any of the terms of the stock contract among the stockholders and between the stockholders and the corporation, and the only provisions of the charter that relate to the capital stock and that require consideration here are the following:

"The capital stock of said company shall consist of two thousand shares of the value of fifty dollars each, being one hundred thousand dollars, and with the privilege of increasing the same, by a vote of the holders of a majority of the stock present at any annual or special meeting, to such an amount as they may from time to time deem needful" (Transcript, p. 194).

"should the capital stock at any time be increased, the stockholders, at the time of such increase, shall be entitled to a *pro rata* share of such increase, upon the payment of the instalments thereon duly called for;" (Transcript, p. 194).

"That the capital stock of said company as authorized by said act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said company may from time to time determine;" (Transcript, p. 196).

It is also provided:

"That the stockholders of the said company, by and with the advice and consent of the holders of two-thirds of the shares of stock, be and they are hereby authorized to change the name and title of the said company," (Transcript, p. 190).

The terms and conditions of the stock contract must, therefore, be found in the stock certificates themselves.

The Reading Company is not a common carrier, and is not subject to regulation by Federal or State authorities having jurisdiction of railroads (Transcript, p. 157).

Prior to 1896 the Reading Company was an inactive corporation, with an authorized capital stock of \$100,000, whose charter had been kept alive and was in the possession of The Philadelphia and Reading *Railroad* Company (hereinafter called the "Railroad Company"). In that year a reorganization of the properties of the Railroad Company and The Philadelphia and Reading Coal and Iron Company (hereinafter called the "Coal Company") became necessary by reason of the foreclosure of the General Mortgage of said companies (Transcript, p. 158).

The reorganization plan dated December 14, 1895, provided for an issue of general mortgage bonds, preferred stock and common stock, as follows:

"1. General Mortgage 100-year 4% Gold Bonds.

* * * * *

"2. Non-cumulative 4% First Preferred Stock for \$28,000,000, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock. The First Preferred Stock will entitle the holders to non-cumulative dividends up to 4% per annum, payable out of net earnings before any dividends shall be paid on the Second Preferred or the Common Stock.

"3. Non-cumulative, 4% Second Preferred Stock for \$42,000,000, which will entitle the holders to non-cumulative dividends up to 4% per annum, payable out of net earnings before any dividends shall be paid on the Common Stock.

"4. Common Stock for \$70,000,000, subject to an increase of \$21,000,000, as hereinafter stated, for substitution for Second Preferred Stock.

* * * * *

"Provision will be made that at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the First Preferred Stock, the New Company may convert the

Second Preferred Stock at par, one-half into First Preferred Stock and one-half into Common Stock" (Transcript, p. 159).

The properties formerly of the Railroad Company and the Coal Company were sold under foreclosure to purchasers who acted by arrangement with the reorganization managers. The capital stock of Reading Company was increased to provide for the issue of the preferred stocks and common stock set forth in the reorganization plan; and such stocks and \$50,369,000 principal amount of General Mortgage bonds were issued against the acquisition of the properties of the Railroad Company and the Coal Company and were exchanged for outstanding securities of the Railroad Company or sold to provide the cash necessary for organization purposes (Transcript, pp. 159, 160).

In the consummation of the reorganization plan the Reading Company became the owner of \$8,000,000 par value, being all, of the capital stock of the Coal Company and the owner of all of the capital stock of the new Philadelphia & Reading *Railway* Company, which had succeeded to most of the properties of the Railroad Company. The Reading Company and the Coal Company became joint obligors of the General Mortgage and the bonds issued thereunder (which are referred to in the Plan as modified, out of which this appeal arises) and the stocks of the Coal Company and the Railway Company, as well as the properties of the Coal Company, were subjected to the lien of said General Mortgage (Transcript, pp. 157, 158).

The preferred stocks and common stock, as provided for in the reorganization plan, were issued by Reading Company in the form shown by the certificates of the first preferred stock (Transcript, p. 88), second preferred stock (Transcript, p. 90) and common stock (Transcript,

p. 92), to which certificates resort must be had for the terms and conditions of the stock contract among the stockholders and between the stockholders and Reading Company, in view of the absence thereof in the charter, as heretofore pointed out.

The Questions Involved.

Under the decree of the District Court (Transcript, p. 287), which made mandatory the segregation plan as modified (Transcript, p. 274), the Reading Company is required to sell, assign and transfer, subject to the lien of the General Mortgage, all its right, title and interest in and to the stock of the Coal Company to a new corporation, in consideration of the payment by the new corporation to Reading Company of the sum of \$5,600,000 and the agreement of the new corporation to issue its 1,400,000 shares of stock, without par value, to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2 for each share of Reading stock (Transcript, p. 275), and, in addition thereto, the Coal Company will pay to Reading Company \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in new 4% Mortgage bonds of the Coal Company; and Reading Company will agree with the Coal Company that, at or before the maturity of the General Mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the General Mortgage and discharge the Coal Company from liability on the General Mortgage bonds (Transcript, pp. 274, 275).

In other words, Reading Company will receive in the aggregate \$40,600,000 for its entire interest in the Coal Company (Transcript, p. 163).

The interest of Reading Company in the Coal Company, as shown by its balance sheet as of December 31,

1919 (Transcript, pp. 114, 115), was carried on its books as follows:

The Philadelphia and Reading Coal and Iron Company's stock.....	\$8,000,000.00
The Philadelphia and Reading Coal and Iron Co.	69,919,770.06
Total	<u>\$77,919,770.06</u>

The same balance sheet shows that on December 31, 1919, the profit and loss account, or corporate surplus, of Reading Company was \$33,201,149.81 (Transcript, p. 115).*

From the foregoing, it will be seen that upon the disposition of its interest in the Coal Company, Reading Company will receive assets to the amount of \$40,600,000 and will surrender assets of a book value of \$77,919,770.06, leaving a deficiency of \$37,319,770.06, and this deficiency will more than wipe out the corporate surplus of upwards of \$33,000,000.

Reading Company in its answer to intervening petitions and cross petition (Transcript, p. 153) admits that this will be the effect of the consummation of the Plan as modified and made mandatory by the decree appealed from, but explains that this effect will be more than counterbalanced by the taking up on the books of Reading Company the corporate surplus of the Railway Company, with which Reading Company is to be merged or consolidated, to the end that the final corporate surplus will exceed the existing corporate surplus of upwards of \$33,000,000 (Transcript, p. 169), as illustrated by the balance sheets annexed as an exhibit to said answer and cross petition (Transcript, p. 200), wherein it is shown

* The balance sheet of Reading Company as of December 31, 1920 (Transcript, p. 200), has not been used because it does not separately show the Coal Company's stock, but the items appearing thereon for the indebtedness of the Coal Company to the Reading Company and the corporate surplus of the Reading Company are substantially the same as those given above for December 31, 1919.

that the corporate surplus of \$33,996,983.01 as of December 31, 1920, will be \$54,115,478.43 after the merger or consolidation of the Reading Company and the Railway Company.

The first and second preferred stocks of Reading Company are "entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on" the common stock (Transcript, pp. 88, 90), and full dividends, at the rate of 4 per cent. per annum, on both the first and second preferred stocks, have been paid since the year 1903 (Transcript, pp. 103, 104).

These appellants contend, therefore, that, inasmuch as the preferred stocks have received their full dividends and the disposition of the interest of Reading Company in the Coal Company results in a depletion of the corporate surplus,* the preferred stocks are not entitled to share in such disposition.

These appellants further contend that, inasmuch as Reading Company owns all of the stock of the Railway Company, and may, therefore, at any time transfer the corporate surplus of the Railway Company to itself, it is no answer to say that the depletion of the corporate surplus of Reading Company may be made good by the surplus of the Railway Company. For all practical purposes, the two surpluses are merely parts of the same surplus.

Some suggestion has been made to the effect that the debt of the Coal Company to Reading Company, which on December 31, 1919, was \$69,919,770.06 (Transcript, p. 114) and on December 31, 1920, was \$69,357,017.99 (Transcript, p. 200), as above pointed out, is not real.

* A depletion of the corporate surplus is not necessarily the *natural* result of disposing of this interest under the mandate of this Court, but it is necessarily the result of the *artificial* features of the plan, as hereinafter set forth.

This debt was discussed by Circuit Judge McPherson in the earlier proceedings in the District Court, where, among other things, the Court found that

“the debt is certainly carried on the books of both companies as an open account between them, and instalments of interest are certainly being paid thereon from time to time.”

(226 Fed. Rep. 229, at p. 269.)

This item of debt has not remained constant, but has varied from time to time since December 1, 1896, and interest thereon, in varying amounts, was paid, or credited, by the Coal Company to the Reading Company during each of the years 1900 to 1913, inclusive (Transcript, pp. 105, 106).

But it is not material for the purposes of this discussion whether the item is a genuine debt or not. The Reading Company carries it as an asset (Transcript, p. 114), and the Coal Company carries it as a liability (Transcript, p. 116). If it should be wiped out, the result would simply be to increase by that amount the value of the Coal Company's stock, all of which is owned by the Reading Company. The principles here involved will not, therefore, be affected by any discussion of the genuineness of this item, and the appellee Reading Company concurs in this view (Transcript, p. 162).

The position of these appellants is that, at least so long as the Reading Company continues to exist and function, all of its surplus, being an amount equal to the difference between the value of the assets, on the one side, and debts and par amounts of capital stock, on the other side, belongs to the common stockholders after “non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year” shall have been paid to the preferred stocks.

The position of these appellants is, further, that assets of a corporation may be distributed to its stockholders

in only two ways: first, either in cash or property by way of dividends, where there is a surplus against which the distribution may be charged, and, second, by way of distribution of capital which necessitates reduction of the capital stock, it being apparent that any distribution of assets to the stockholders must result either in depleting the surplus or reducing the capital stock.

In view of this position, these appellants have contended, and now contend, that the disposition of the interest of Reading Company in the Coal Company provided in the Plan as modified and as made mandatory by the decree of the District Court confers upon the preferred stockholders a benefit to the prejudice of the legal rights of the common stockholders.

In order to bring this Plan into harmony with the legal rights of the common stockholders, these appellants made three suggestions to the District Court, which were to treat the disposition of the interest of Reading Company in the Coal Company as either

- (1) A distribution of capital, in which case the capital stock, preferred and common alike, should be reduced by the amount of such distribution; or

- (2) A distribution of surplus, in which case it should be made to the common stock alone; or

- (3) A sale of assets, in which case the proceeds should be placed in the treasury of Reading Company.

The first and third suggestions avoided the necessity of deciding the question as to the respective rights of the preferred and common stocks in the surplus of the Company, or of deciding what are the rights of the preferred stock therein. The second suggestion was based upon the assumption that the decision, if it were made, would

be in favor of the common stockholders—that is, that they own the surplus.

All of these suggestions were disregarded and this appeal is the result.

Specification of the Errors.

1. The Court erred in approving that part of paragraph 5 of the Modified Plan as supplemented by the provisions of sub-paragraph (c) of paragraph 3 of said decree which provides that the Reading Company shall offer for subscription to its stockholders, preferred and common, share and share alike, at \$2. for each share of Reading stock, assignable certificates of interest in the stock of the new corporation to which the Reading Company shall, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of Philadelphia & Reading Coal & Iron Company (hereinafter called the "Coal Company").

2. The Court erred in ordering the consummation of the provisions of that part of paragraph 5 of the Modified Plan as supplemented by the provisions of sub-paragraph (c) of paragraph 3 of said decree which provides that the Reading Company shall offer for subscription to its stockholders, preferred and common, share and share alike, at \$2 for each share of Reading stock, assignable certificates of interest in the stock of the new corporation to which the Reading Company shall, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company.

3. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company provided for in paragraph 5 of the Modified Plan as supplemented by the

provisions of said decree does not confer upon the holders of the preferred stock of the Reading Company a benefit to the prejudice of the legal rights of the holders of the common stock of the Reading Company.

4. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a sale to the stockholders of the Reading Company of such right, title and interest.

5. The Court erred in holding that the sum of \$5,600,000, or \$2.00 for each share of stock of the Reading Company, is an adequate consideration for the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company.

6. The Court erred in holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a disposition of a part of the capital of the Reading Company.

7. The Court erred in not holding that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree effectuates a distribution in part at least of or from the surplus net profits of the Reading Company.

8. The Court erred in holding that it was warranted in treating as acquiescing in the Modified Plan the holders of common stock of the Reading Company who had failed to object thereto.

9. The Court erred in holding that it was justified in concluding from the positive attitude of a holder of 100,000 shares of common stock of the Reading Company that the remainder of the holders of such stock who failed to object to the Modified Plan were not only passively acquiescing in, but really actively approving, the same.

10. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company provided in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is in violation of the legal rights of the holders of the common stock of the Reading Company.

11. The Court erred in that it did not hold that the holders of the common stock are solely entitled to distributions out of surplus net profits of the Reading Company of years other than those in which the full dividends shall not have been paid on the first and second preferred stock.

12. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is not a sale of such right, title and interest.

13. The Court erred in that it did not hold that the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company as set forth in paragraph 5 of the Modified Plan as supplemented by the provisions of said decree is a distribution in part at least of or from the surplus net profits of the Reading Company.

14. The Court erred in that it did not hold that the holders of the preferred stock of the Reading Company are entitled to non-cumulative dividends not exceeding 4% per annum and no more.

15. The Court erred in that it did not hold that the Modified Plan as supplemented by the provisions of said decree does not effectuate a dissolution or liquidation of the Reading Company.

16. The Court erred in holding that the right of the stockholders of the Reading Company to participate in the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company is based on the corporate right of all shareholders in a Pennsylvania Corporation to share equally on a disposition of its assets.

17. The Court erred in not holding that the rights of the stockholders of the Reading Company to participate in the disposition of the right, title and interest of the Reading Company in and to the stock of the Coal Company are determined by the contractual rights existing between the Reading Company and its stockholders and among said stockholders, which contractual rights are expressed in the certificates of the first preferred, second preferred and common stocks of the Reading Company.

ARGUMENT.

I.

The disposition of the interest of Reading Company in the Coal Company required by the decree is not a sale.

The disposition of the interest of Reading Company provided for in the Plan as modified and as made mandatory by the decree appealed from is not a sale in any real sense.

It is true that this disposition takes the technical form of a sale, in that title to property is to pass in consideration of the payment of a price, but all resemblance to a real sale ends there.

The price is purely arbitrary, and the Plan as modified and made mandatory by the decree contains no intimation, much less explanation, of how this price was determined. The appellee Reading Company, in its answer to intervening petitions and cross petition, states:

"It is evidently impracticable to ascertain the market value of the coal stock * * * without offering it for sale. An appraisal would be of no use whatever under the circumstances. The Reading Company is under the necessity of making an actual disposition of the stock and no theoretical valuation of appraisers or experts could be of the least service unless they were willing and able to back the appraisal with a bid" (Transcript, p. 163).

It is suggested, however, that a valuation of appraisers or experts, no matter how theoretical, would be entitled to more serious consideration than a purely arbitrary and wholly unexplained price.

This answer and cross petition also states:

"The coal stock is being sold for less than its book value and it is not asserted on behalf of the intervening common stockholders that it can be sold for as much as its book value. The sale results in a loss on the books of the Reading Company, yet the intervening common stockholders ask that it be treated as a distribution of profits and that the preferred stockholders be excluded from participation in the purchase on that theory" (Transcript, pp. 163, 164).

While these appellants do not assert that said stock can be sold for as much as its book value, they do assert that it can be sold for a price far in excess of the price named in the Plan as modified and made mandatory by the decree. This assertion is not based upon any theoretical valuation of appraisers or experts, but upon actual market conditions. In the affidavit of Austin W. Penchoen, verified March 12, 1921, and contained in the petition of Frances T. Ingraham *et al.*, it is stated:

"That since the Reading plan was announced, the sale for the rights for each share of the Reading stock has been as follows:

High	20
Low	13½"

(Transcript, p. 128.)

The Reading plan referred to in the foregoing quotation is the plan which was filed in the District Court on February 14, 1920 (Transcript, p. 40), and the foregoing quotation means that between that date and March 12, 1921, holders of stock of Reading Company were able to sell their rights to participate in the disposition of the interest of the Reading Company in the Coal Company at from \$13.50 to \$20 per share of Reading Company stock, whereas the Plan as modified and made mandatory by the decree entitles them to said rights upon the payment of \$2 per share of Reading Company stock.

These high and low prices reflect the public opinion of the value of the interest of Reading Company in the Coal Company during the period referred to, and, while they do not necessarily indicate the price at which this entire interest could have been sold, they are sufficient to show the purely arbitrary nature of the price named in the Plan as modified and made mandatory by the decree and of the gross inadequacy thereof.

That the sale results in a loss on the books of the Reading Company is due to the purely arbitrary and wholly unexplained price and the evident inadequacy of such price.

Nevertheless, said answer and cross-petition states that

“The sale is compulsory and will result in a loss, not a profit” (Transcript, p. 162).

and that

“It is the nature of the asset disposed of, and the method of its disposition, not the effect of such disposition on the books of the corporation, which fixes the rights of stockholders in respect of such disposition” (Transcript, p. 165).

That the sale is compulsory is due to the mandate of this Court, but that the sale will result in a loss and not a profit, is due to the price that has been fixed by Reading Company in its uncontrolled discretion. And, granting, for purposes of argument, that it is the nature of the asset disposed of, and the method of its disposition, not the effect of such disposition on the books of the corporation, which fixes the rights of the stockholders in respect of such disposition, this cannot be true where the method of disposition is to distribute assets of a corporation to its stockholders, preferred and common, share and share alike, under the guise of a sale and at a purely nominal price, and thus arbitrarily produce an effect on the books of the corporation which adversely affects the rights of the common stockholders in respect of such disposition.

The loss on the books of the Reading Company that results from this sale, and that these appellants are asking to be treated as a distribution of profits, is represented, in part at least, by the difference between the arbitrary and unexplained sale price and the real value of the interest that is being disposed of, and, under the Plan as modified and made mandatory by the decree, the preferred stockholders would benefit to the extent of one-half of that difference. In other words, this loss is a purely artificial one that has been created by means of the arbitrary and unexplained sale price, and apparently for the purpose of permitting the preferred stockholders to reap the benefit to which these appellants claim the preferred stockholders are not entitled.

II.

The so-called sale of the interest of Reading Company in the Coal Company required by the decree is not in conformity with previous decrees of the Federal Courts under similar circumstances, particularly the Union Pacific-Southern Pacific segregation, so far as the relative rights of the common and preferred stocks are concerned.

The Plan as modified (Transcript, p. 274) and made mandatory by the decree recites that

"It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific-Southern Pacific case, by issuing to Reading stockholders, with or without the intervention of a

trustee, as may be provided for in the final decree of the Court, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company" (Transcript, pp. 275, 276).

In the petition of the appellants Adrian Iselin *et al.*, representing holders of the first and second preferred stock of Reading Company, it is stated that the proposed distribution is in conformity with previous decrees of the Federal courts under similar circumstances, and the decree in the *Union Pacific-Southern Pacific* case is given as an illustration (Transcript, pp. 137, 138). This alleged similarity between the Plan as modified and made mandatory by the decree and the plan carried out in the *Union Pacific-Southern Pacific* case, so far as it relates to the treatment of the relative rights of the common and preferred stocks, will not bear analysis. As is hereafter shown, the treatment accorded by the Union Pacific Railroad Company to its common stockholders is precisely the treatment that these appellants contend should be accorded by the Reading Company to its common stockholders.

In that case, after the decision of the Supreme Court and before the mandate therein had issued, the Government and the Union Pacific and the Oregon Short Line united in a motion to this Court praying for advice to the District Court as to the form of the mandate.

It will be recalled that the stock of the Southern Pacific Company, which this Court ordered the Union Pacific and Oregon Short Line to dispose of, belonged not to the Union Pacific, but to the Oregon Short Line, the stock of which was owned by the Union Pacific. It was analogous to the surplus of the Reading Railway Company in this case. In the *Union Pacific* case, therefore, the situation being dealt with was analogous to the

situation being dealt with in this case as to the Reading Railway Company's surplus and one step further removed than the Reading Company's surplus of \$33,000,000, which also is involved in this case.

In their said joint motion to this Court, the Government and the railroad companies joined in asking the Court:

"to instruct the United States District Court for the District of Utah, by a provision incorporated in the mandate of this court, when issued, or otherwise, whether or not a sale of the Southern Pacific Company shares held by said appellees to the shareholders of appellee Union Pacific Railroad Company, substantially in proportion to their respective holdings, *or a distribution thereof by dividend to the Union Pacific stockholders entitled to such dividend*, would, in the opinion of this court, constitute a disposition of said shares in compliance with the opinion herein filed on December 2, 1912." (Italics are ours.)

U. S. v. Union Pacific R. R. Co., 226 U. S., at p. 471.

Also counsel for the Union Pacific and Oregon Short Line, in their printed argument to the Supreme Court on said motion, used the following language:

"While no plan for the disposition of said Southern Pacific Company shares has been definitely matured, it is considered for reasons hereinafter stated that the only practicable method for the disposition of said shares without irreparable injury would be for the Union Pacific Railroad Company to offer said shares to its own shareholders *pro rata* according to the amount of their holdings, for purchase *at a fair price or to distribute the same as a dividend to the holders of its stock entitled to such dividend*." (Italics are ours.)

The Union Pacific and its counsel were always alive to and observant of the respective rights of their preferred

and common stocks. Manifestly they never entertained any thought that the preferred stockholders were entitled to a dividend above their 4%. They submitted to the Court the alternatives of purchase *at a fair price* or distribution by dividend to the *stockholders entitled to such dividend*. That was in September, 1913. In January, 1914, when the Company came to the point of declaring the extraordinary dividend of \$80,000,000 (largely out of the proceeds of the sale), that was challenged by the preferred stockholders and resolved against them (*Equitable Life Assurance Society v. U. P. R. R. Co.*, 212 N. Y. 360), all of that dividend was declared to the common stock and was sustained.

This Court in the Union Pacific dissolution accepted the alternative of *sale* to all the stockholders, both common and preferred, but it was a very real sale. The decree provided that the offering should be at such price and upon such other terms as the defendants, Union Pacific Railroad Company and Oregon Short Line Railroad Company, should determine (*Section 5 of decree of June 30, 1913. Decrees and Judgments in Federal Anti-Trust Cases published by Government Printing Office, 1918, page 221*). The price so fixed was \$92 per share (which included about \$4 of accumulated dividends).

The high and low prices on the New York Stock Exchange for Southern Pacific Company's stock in the years 1911, 1912 and 1913 were respectively:

	High.	Low.
1911.....	126 $\frac{3}{8}$	104 $\frac{1}{2}$
1912.....	115 $\frac{1}{2}$	103 $\frac{1}{2}$
1913.....	110	83

The low price in June, 1913 (the date of the decree) was 89 $\frac{3}{8}$, and it never sold on the market above 90 $\frac{5}{8}$ during the rest of that year (*The Financial Review, New York, 1914, pages 139, 142, 145*). What was done in the Union Pacific case was a *sale*, not a *distribution*, but in

the instant case, while the plan calls it a sale, the price to be paid is only \$2 per share of Reading stock (producing \$5,600,000), which works out to a payment for the present Coal Company's stock of \$35 per share (\$8,000,000 of stock of \$50 per share is 160,000 shares, which at \$35 per share produces \$5,600,000), whereas the book value of the Coal Company's stock after this transaction has been consummated and the \$35,000,000 cash and bonds have been paid out and issued, making the surplus of the Coal Company \$60,000,000, will be about \$425 per share, as hereinafter explained.

And so the real result of the so-called sale in the instant case is not a sale for anything approaching the value of the assets sold, but is a price less than one-tenth of the real value, the rest being made up, however the figures may be turned and twisted, by the absorption of the surplus of the Reading Company, that is, the distribution to the Reading preferred and common stockholders alike, of the surplus of the Reading Company.

The *Union Pacific-Southern Pacific* case, therefore, instead of being a precedent to support the present transaction, is a precedent exactly opposite, because in that case the company contemplated and offered to the Court the alternatives of a real sale to all of the stockholders or a dividend to the stockholders entitled to a dividend, and the Court having accepted the former alternative, the company carried out the plan by a sale at a price approximating the then market value of the stock.

In this case the Reading Company contemplated and offered to the Court no alternative whatever, but was successful in having the Court accept and make mandatory a Plan providing for the disposition of its assets at a price which is arbitrary, wholly unexplained and manifestly inadequate.

If Reading Company had followed in the footsteps of the Union Pacific Railroad Company and had obtained

the sanction of the District Court to such a plan as was consummated by the Union Pacific Railroad Company, these appellants would not be before this Court with this appeal. In fact, as is more fully set forth under III hereof, these appellants suggested to the District Court a modification of the Reading plan that would have been satisfactory to them and that would have obviated this appeal, which suggestion was to the effect that the interest of Reading Company in the Coal Company should be sold at as nearly as possible its market price, and that the proceeds of the sale should be placed in the treasury of Reading Company, precisely as was done by Union Pacific Railroad Company in the disposition of its interest in the Southern Pacific Company.

Obviously, it is idle for Reading Company and the representatives of the holders of its preferred stock to cite as a precedent for the plan of which these appellees are complaining a plan substantially similar to modifications of the Reading plan that were suggested by these appellants in the District Court.

III.

If the disposition of the interest of Reading Company in the Coal Company required by the decree is intended to be a sale, the decree should be so modified as to carry out such intent.

It has already been shown that the disposition by the Reading Company of its interest in the Coal Company as required by the decree is not a sale in any real sense, and that it is the disposition of such interest at an arbitrary, wholly unexplained and manifestly inadequate

price and the resulting depletion of the corporate surplus of Reading Company that has brought on the controversy out of which this appeal arises.

In order to avoid the necessity either of ascertaining the true value of such interest or of determining the respective rights of the preferred and common stocks therein, these appellants suggested to the District Court at the hearing on May 2, 1921, and now suggest to this Court, the following modification of the plan made mandatory by the decree:

Certificates of the interest of the Reading Company in the stock of the Coal Company, such interest being the equity over and above the lien of the General Mortgage referred to in said Plan, shall be dealt with as follows:

A. The certificates of interest shall be lodged with a trustee to be appointed by the District Court, or shall be transferred to a new corporation to be made a party to the proceeding below and subjected to the control of the District Court.

B. Such trustee or new corporation shall, under the control and direction of the Court, exercise the voting power of the Coal Company stock and receive the dividends thereon pending the sale of the certificates of interest.

C. Reading Company shall proceed to sell the certificates of interest to such purchasers and under such restrictions as may be approved by the District Court, to the end that the purposes of the mandate of this Court may be fully effectuated and within such time as the District Court may grant for the purpose of accomplishing such sale to the best advantage.

D. If desirable and practicable, the Coal Company may be consolidated with Delaware Coal Company, of which it owns the entire capital stock, and the consolidated company may then issue 1,400,000 shares of stock, without par value. These

shares shall be placed under the lien of the General Mortgage in lieu of the present Coal Company stock, and be dealt with as provided above. If such consolidation is not practicable, the new corporation suggested in paragraph "A" may issue 1,400,000 shares of stock, without par value, to be sold as provided in paragraph "C".

This suggestion contemplates that no distribution whatever be made to the stockholders of Reading Company, and that the proceeds of the sale of its interest in the Coal Company be placed in the treasury of Reading Company, to be dealt with as any other treasury assets.

This suggestion is based upon the plan recently approved by the Government and adopted by the Supreme Court of the District of Columbia in the case wherein the Armour and Swift packing companies were required to dissolve their relations with numerous stockyard companies by disposing of their stock holdings therein. It is analogous to the method employed in the *Union Pacific-Southern Pacific* case, wherein the Union Pacific Railroad Company sold its interest in the Southern Pacific Company at approximately the market price and placed the proceeds of the sale in its treasury.

This suggestion, by keeping the voting power of the Coal Company's stock and the right to receive the dividends thereon under the control of the District Court until such time as the interest of the Reading Company therein can be sold to purchasers who are independent of the Reading Company, insures compliance with the mandate of this Court. By allowing such time as to the District Court may seem proper within which to sell the interest of Reading Company in the Coal Company stock, and by permitting the Reading Company to manage its sale, a sacrifice of the same in a market overhung by abnormal financial conditions is made unnecessary. And by reason of the fact that the proceeds of such sale would

go into the treasury of the Reading Company, and be dealt with as any other treasury assets, this suggestion makes unnecessary any discussion of the respective rights of the preferred and common stocks, because it does not, as does the Plan made mandatory by the decree, raise any questions regarding such rights.

IV.

The disposition of the interest of Reading Company in the Coal Company under the decree cannot be justified on the ground that it is a disposition of a capital asset.

The answer to intervening petitions and cross petition of the appellee Reading Company (Transcript, p. 153) attempts to justify the distribution of the interest of Reading Company in the Coal Company to the stockholders, preferred and common, share and share alike, on the ground that it is a disposition of a capital asset.

This attempt, as we understand it, is supported on the theory that certain assets are earmarked as capital assets, and have some characteristics that distinguish them from other assets of the corporation.

This theory seems to arise from the mistaken assumption that only such assets as have come to the corporation as earnings, income or profits may be distributed to stockholders by way of dividends, and that the distribution of an asset that was acquired by a corporation out of capital originally subscribed by its stockholders takes on some characteristics that distinguish it from an ordinary dividend and that preclude its being dealt with as such.

As illustrating this, let it be assumed that a corporation commences business with a capital of \$100,000 in

cash paid in by its stockholders; that, out of such cash, it expends \$50,000 in the purchase of securities for permanent investment; that thereafter it expends, out of the cash derived from earnings, income and profits, a further sum of \$50,000 for the acquisition of additional securities for permanent investment. If thereupon the corporation should declare a dividend of \$50,000, to be paid by a distribution of the securities first acquired, could it be said that such distribution would not be governed by the ordinary rules of law relating to dividends, but would be governed solely by the fact that it was a distribution of "capital assets", and, therefore, taken out of the rules of law relating to dividend distributions, in case any contest between the preferred and common stockholders should arise in respect thereto? The assumption of the appellee Reading Company, as applied to this case, would require that the securities first acquired and out of capital could not be distributed as a dividend, and that only the securities later acquired and out of earnings, income and profits could be so distributed.

But a corporation in dealing with its assets is not required to classify its assets as between those that were acquired by means of the contributions of its stockholders to its capital and those that are acquired from time to time through earnings, income and profits. Nor is it required to make distributions of its assets to its stockholders according to such classification and practically in specie, as the foregoing assumption suggests.

We are unable to discover any authority for the theory that is advanced or the assumption from which it seems to arise. The authorities are to the contrary, and sustain the following propositions:

- 1. That the surplus of a corporation is the difference between the value of its assets, on the one side, and the debts and par amounts of capital, on the other side.**

2. That none of the assets of a corporation is identified as capital, and none is identified as surplus.

3. That, where a surplus exists, it may be distributed to the stockholders entitled thereto, either in money or in property.

The Supreme Court of Iowa, in *Hubbard v. Weare* (79 Ia. 678, at pp. 688-9; 44 N. W. Rep., at p. 918), states the rule as follows:

"Some difference is expressed as to what are profits, and how they are to be arrived at. This is answered in *Miller v. Bradish*, 69 Iowa, 278 (28 N. W. Rep. 594), where it is said: 'The assets, resources, and funds of the corporation must consist of cash on hand and other property, and, if such assets exceed the liabilities, a dividend can lawfully be declared;' in other words, a profit exists."

The Court of Appeals of the State of New York, in *Williams v. Western Union Telegraph Co.*, 93 N. Y. 162, discussed at length the meaning of "capital stock" and "surplus", with citation of authorities. Earle, J., lays down the rule that when a corporation's property exceeds the amount of capital stock limited by its charter, the excess is surplus.

"Such surplus belongs to the corporation and is a portion of its property, and, in a general sense, may be regarded as a portion of its capital, but in a strictly legal sense it is not a portion of its capital, and is always regarded as surplus profits" (at p. 188).

And as to the distribution thereof the opinion continues:

"The surplus may be in cash, and then it may be divided in cash; it may be in property, and if the property is so situated that a division thereof among

the stockholders is practicable, a dividend in property may be declared, and that may be distributed among the stockholders" (at p. 189).

The Appellate Division of the New York Supreme Court, First Department, in the case of *Russell v. American Gas & Electric Co.* (152 A. D., at p. 138), lays down the rule in the following language:

"Where a corporation has property in excess of the amount of its capital stock, the excess is surplus which may be divided among the stockholders entitled to share therein, either in money or property."

In the recent case of *Anderson v. Farmers' Loan and Trust Co.*, decided by the United States Circuit Court of Appeals, Second Circuit (241 Fed. Rep. 322), the Court discusses the question as to whether any particular assets of a corporation can be identified as forming its capital or any particular assets can be identified as forming its surplus, and reaches the following conclusion:

"The words 'capital, surplus and undivided profits' relate to no particular kind of property, but are expressions describing the amount of the residue of the assets after the liabilities have been deducted" (at pp. 326, 327).

And again on page 328:

"We do not regard any specific assets as constituting capital of the company. The capital, and in the same way the surplus and undivided profits, are the residue left after paying the obligations of the bank to its depositors, and any other indebtedness it may have. These claims may be satisfied out of any property, and the balance remaining, which is the capital, surplus and undivided profits, is to be imputed equally to all kinds of property which the trust company may possess."

In that case the Court was considering the situation of a trust company which, by the New York statute, was

required to have a certain portion of its capital invested in certain kinds of securities. Therefore, the trust company contended that it could point to such securities and name them as a part of its capital; and the Court, after full discussion and citation of authorities, reached the conclusion that the rule is sound that these items, capital and surplus, applied to a corporation, are mere book-keeping items, that they point to no particular investments, that they are merely the difference between the assets and liabilities of the corporation, and that, after deducting them from the amount of the capital stock, the balance is surplus.

This Court, in *St. John v. Erie Ry. Co.*, 22 Wall. 136, at page 149, states the legal principle as follows:

“There is nothing in the agreement or the statute, and we are aware of no legal principle which would authorize the stockholders in question to analyze the business, select out a part of it, and to say that the *net earnings* specified must be a predicate of that part, and of none other. The Company had the right to conduct its operations, in good faith, as it might see fit; and it was from them and all of them that the materials for the computations of earnings were to be derived” (*italics ours*).

An exhaustive search of the authorities has failed to disclose any case where the respective rights of the preferred and common stockholders of a corporation in a distribution of its assets were held to be governed by the nature of the assets distributed, the time at which the assets were acquired or the manner in which they were acquired, whether out of the contributions of the stockholders to the capital of the corporation, or out of the earnings, income or profits.

Up to the point of encroaching on the capital, it is immaterial how the distribution is made. It is a dividend and it may be paid either in cash or in property.

V.

If the disposition of the interest of Reading Company in the Coal Company required by the decree is intended to be a distribution of capital, the decree should be so modified as to carry out such intent.

It is obvious that the assets of a corporation may be distributed to its stockholders in only two ways: first, either in cash or property by way of dividends, where there is a surplus against which the distribution may be charged, and, second, by way of distribution of capital, which necessitates a reduction of the capital stock.

Having suggested that if the disposition of the interest of Reading Company in the Coal Company required by the decree is intended as a sale, the decree should be so modified as to carry out such intent, and having suggested a modification of the Plan as made mandatory by the decree for the purpose of carrying out such intent, these appellants further suggest that if the disposition of the interest of Reading Company in the Coal Company is intended to be a distribution of capital, the decree should be so modified as to carry out that intent.

These appellants suggested to the Court below, and now suggest to this Court, a modification of the Plan approved and made mandatory by the decree which will bring the Plan and decree into harmony with the contention of the appellee Reading Company that it brings about a distribution of capital. This suggestion is set forth in the petition of these appellants for leave to intervene (Transcript, p. 96), and is set forth and more fully explained in their amended and supplemental petition for modification of the plan of dissolution (Transcript, p. 101), and is as follows:

"XIII. That inasmuch as the Reading Company is obliged under the decree of the Court to divest

itself of said assets, being the stock and debt of defendant Coal & Iron Company, and under said plan receives therefor considerations which fall short of the value of said assets, it appears to be necessary either (a) to eliminate the surplus of defendant Reading Company as it now exists or to reduce the surplus of the Reading Company as it will exist after the proposed merger with the Philadelphia & Reading Railway Company, or (b) to reduce the capital stock of the Reading Company, provided that the principle of said plan is to be carried out of making an equal distribution to both the preferred and common stocks in connection with the divesting of said assets. That in order to obviate such inequity arising under said plan, your petitioners respectfully suggest the following modification thereof by the addition to article 5 thereof of the following:

‘Coincidentally with the issuance and distribution of the certificates of interest in the Coal Company stock, as aforesaid, the Reading Company will reduce its capital stock by the amount of \$..... such reduction to apply to all shares of the stock of the Reading Company equally, regardless of classification into preferred and common, and such reduction to be effected by decree of the Court directing it should the Court accept this plan and so decree.

‘For the purposes of carrying out such a provision, jurisdiction of the case shall be retained by the Court.’

“That the amount by which such reduction should be made is the net value of the assets of which the Company is required to divest itself, namely:

“The true value of the \$8,000,000 capital stock of the Coal Company and of the \$69,919,770 debt of the Coal Company to the Reading Company, such value to be ascertained in such manner as to this Court shall seem proper and sufficient, less \$25,000,000 bonds and \$10,000,000 cash or current assets to be received from the Coal Company and \$5,600,000 cash to be received from the stockholders” (Transcript, pp. 109, 110).

This modification would bring about a true distribution of capital, and leave the surplus of Reading Company, whether disclosed or latent, untouched. Because of the fact that Reading Company has the right to redeem the preferred stock, a distribution of capital equally to all classes of stock amounts to a redemption of the preferred stock *pro tanto*, and, therefore, preserves all of the equities between all classes of stockholders.

The reason why, under this suggested modification, an appraisal of the value of the Coal Company's stock would be necessary is because that stock is worth much more than par, and so a distribution thereof to all stockholders by a uniform reduction of the capital stock, which, because of the redemption right against the preferred stocks would amount to a *pro tanto* redemption thereof, would not be equitable to the common stock if the Coal properties should be distributed on a valuation basis materially below their actual value. This may be illustrated by the fact that the Coal Company on December 31, 1920, had a surplus of over \$25,000,000; that under the Plan as made mandatory by the decree, a debt of approximately \$70,000,000 disappears, and new liabilities of \$35,000,000 arise, or a net gain in the balance sheet of the Coal Company of \$35,000,000; and that this added to the surplus, gives the Coal Company a surplus of \$60,000,000, and makes the \$8,000,000 of Coal Company stock worth, therefore, between eight and nine times its par value.

VI.

The disposition of the interest of Reading Company in the Coal Company under the decree cannot be justified on the ground that it is a partial liquidation of Reading Company.

The mandate of this Court pursuant to which the Plan made mandatory by the decree was evolved requires a dissolution of the relations between the Coal Company and the Railway Company that were maintained through the Reading Company's ownership of the entire capital stock of both companies, and thus requires a reorganization of the Reading Company's property holdings. In view of this, the suit brought by the Government in which the mandate was made is often loosely referred to as the "Reading Dissolution Suit" and the "Reading Reorganization Proceeding". Likewise the Plan is often loosely referred to as the "Reading Dissolution Plan" and the "Reading Reorganization Plan".

The only dissolution that is involved in this Plan, however, is the dissolution of the relation between the Coal Company and the Railway Company that was maintained through the Reading Company, and the only reorganization that is involved in this Plan is a reorganization of the property holdings of the Reading Company.

But the currency of these expressions seems to have suggested the theory that the disposition of the interest of Reading Company in the Coal Company required by the decree involves a partial dissolution and partial liquidation of the corporation. Consequently, there appears in the answer and cross petition of defendant Reading Company a discussion of "property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them either upon dis-

solution of the company or its final or partial liquidation" (Transcript, p. 177).

But neither the mandate of this Court nor the Plan made mandatory by the decree involves any dissolution or reorganization of Reading Company, either in whole or in part, in a corporate sense. Reading Company was incorporated with a broad charter which places no limit upon its corporate activities, beyond providing that nothing therein contained "shall be so construed as to give to the said corporation any banking privileges or franchises, or the privileges of issuing their obligations as money" (Transcript, p. 191).

In said charter Reading Company is specifically given the power "to make purchases and sales of or investments in the bonds and securities of other companies" and "to receive and hold * * * any estate or property, real or personal * * * and also to pledge, sell and dispose thereof, on such terms as may be agreed on between them and the parties contracting with them" (Transcript, p. 192, sec. 3).

Acting under these powers, Reading Company in 1896 acquired all of the capital stock of the Coal Company and all of the capital stock of the Railway Company; and this Court having declared the ownership of such stocks by Reading Company to be unlawful, and having required Reading Company to dispose of the stock of the Coal Company, the Plan for such disposition need go no further than to require a sale of the interest of Reading Company in the Coal Company and the substitution of the proceeds of such sale for such interest in the Coal Company among the Reading Company's assets.

Such a plan would involve no corporate change in Reading Company, and such a sale is one that Reading Company could voluntarily make under its broad charter without violating its contract with its stockholders. Under such a plan, there would be no liquidation at all, partial or otherwise, but merely a substitution of one

asset for another; and any legitimate loss that might accrue from a *bona fide* sale, to the best advantage, of the interest of Reading Company in the Coal Company would be a proper charge to the surplus of Reading Company, and would meet with no objection on the part of its common stockholders.

But the Plan made mandatory by the decree places a purely arbitrary and wholly unexplained price upon the interest of Reading Company, which is clearly less than the value of such interest. Having thus artificially created a loss, the Plan proposes to charge this loss to surplus and to give the preferred stockholders equal rights with the common stockholders to participate in this so-called sale at an arbitrary and inadequate price. It is apparent that the preferred stockholders will be benefited by the difference between the value of their purchase and the price they pay for it, and it is also apparent that the loss that is involved in this sale will be made up out of surplus, and will, therefore, serve to reduce the same.

The effect of all this is precisely the same as if Reading Company should declare a dividend of the difference between the value of its interest in the Coal Company and the price for which such interest is to be sold under the Plan, distribute this dividend to all of its stockholders, preferred and common, share and share alike, and reduce the surplus by the amount of such dividend.

Naturally, the common stockholders object to this, on the ground that this distribution, which is a dividend in everything but form, is improper, by reason of the fact that the preferred shares are non-cumulative and that they have received all of the dividends to which they are entitled, and that the common stockholders are entitled to the surplus as against the preferred stockholders.

To meet this objection, the appellee Reading Company has undertaken to show that this distribution is

either a sale or is a disposition of a capital asset, or, finally, is a partial liquidation upon a partial dissolution of the company. For the reasons heretofore explained, these appellates contend that it is neither of these, but is, in substance, in effect, and in everything but form, a dividend, to which they are wholly entitled.

Any proceedings looking to a change in the structure or powers of a corporation must be taken pursuant to the laws of the State that gave the corporation its existence, and while the Federal courts, in the enforcement of provisions of the Sherman Act and the Interstate Commerce Act, may require corporations of the several States to change their business practices and to divest themselves of assets held by them in violation of such laws, the Federal courts do not undertake to bring about through their decrees changes in the structure of State corporations, and thus override the corporation laws of the several States.

In short, the Plan made mandatory by the decree does not involve a dissolution of Reading Company, either wholly or in part, nor does it involve a liquidation of its assets, either wholly or in part. It merely involves a substitution of one asset for another, in such a way, however, that a loss is artificially created and made up out of surplus, to the prejudice of the rights of the common stockholders.

VII.

The distribution of the interest of Reading Company in the Coal Company required by the decree effectuates a distribution, in part at least, of or from the surplus net profits of Reading Company.

Under the Plan as made mandatory by the decree, Reading Company will dispose of its interest in the Coal Company, which was carried on its books as of December 31, 1919, in the following items:

Coal Company's stock.....	\$8,000,000.00
Coal Company's indebtedness to Reading Company	69,919,770.06
Total.....	<u>\$77,719,770.06</u>

In respect of such disposition Reading Company will receive:

Cash, or current assets at market value, from the Coal Company.....	\$10,000,000
Bonds of the Coal Company.....	25,000,000
Cash from the new corporation to which Reading Company will sell, assign and transfer, subject to the lien of the Gen- eral Mortgage, all its right, title and interest in and to the stock of the Coal Company	5,600,000
Total.....	<u>\$40,600,000</u>

This will result in a shrinkage in assets of the difference between these two totals, or, approximately, \$38,000,000. As of December 31, 1919, the surplus of Reading Company was approximately \$33,000,000 and the surplus of the Railway Company was approximately \$44,000,000 (Transcript, pp. 115, 119). This shrinkage

in assets is to be made good in part by the Reading Company's surplus of \$33,000,000, which will thereby be absorbed and eliminated; but, as the Reading Company's surplus will not suffice by approximately \$5,000,000 to make good this shrinkage in assets, this \$5,000,000 deficiency is to be made up out of the surplus of the Railway Company, which, under the Plan, is to be consolidated with Reading Company. All of this is conceded by the appellee Reading Company, and is, in fact, illustrated by the tabulation of balance sheets (Transcript, p. 200) which accompanies its answer and cross petition, and which shows that as of December 31, 1920, the corporate surplus of Reading Company was approximately \$34,000,000, and the corporate surplus of the Railway Company was approximately \$64,000,000—a total of \$98,000,000—and that, after the consummation of the Plan and the consolidation of the Reading Company and the Railway Company, the corporate surplus of the consolidated corporation will be approximately \$54,000,000.

The effect of this on the Reading Company's books is precisely the same as if it should declare a dividend of \$38,000,000 and reduce its surplus by the amount of such dividend.

In an attempted justification of this result, the appellee Reading Company states in its answer and cross petition:

"The capital of the Reading Company will remain unimpaired. Upon the consummation of the plan the assets of the Reading Company will exceed the aggregate of its capital stock and liabilities by an amount in excess of the present surplus of \$33,000,000" (Transcript, pp. 165, 166),

and

"The book surplus of the Reading Company will not be impaired. The book loss from the sale of

the coal stock will be more than made up by taking up on the Reading Company's books in connection with the plan, the value of the railway property, as shown on the books of the Railway Company" (Transcript, p. 169),

which, as is further explained,

"will more than counterbalance what it will be necessary to write off its investment in the Coal Company under the plan. So that in fact the surplus of the Reading Company, after the consummation of the plan, will be much greater than \$33,000,000" (Transcript, p. 169).

This seems to proceed upon the theory that the common stockholders have no interest in the surplus of the Railway Company, and that, if the result of taking over the Railway Company's surplus on the Reading Company's books is more than to make good this shrinkage, and, therefore, leave on the Reading Company's books a surplus greater than the original surplus of \$33,000,000, the common stockholders have no right to complain, and their rights have not been prejudiced.

This, of course, is no justification whatever. The Reading Company owns all of the capital stock of the Railway Company, and, therefore, owns all of the surplus of the Railway Company, which surplus it can reduce to possession either by causing the Railway Company to pay over the same as dividends, or by merging the Railway Company into itself, or consolidating with the Railway Company, as provided in the Plan. It follows that, if the Railway Company's surplus needs to be considered, it is merely necessary to add it to the Reading Company's surplus as carried on its own books, and to deal with the total as the surplus of the Reading Company, just as if the Reading Company had reduced the Railway Company's surplus to possession.

After the Coal Company has paid or delivered to the

Reading Company \$10,000,000 in cash, or current assets at market value, and has delivered to the Reading Company \$25,000,000 principal amount of its new 4% bonds, the interest of the Reading Company in the Coal Company is to be sold to a new corporation, in consideration of the sum of \$5,600,000, and this new corporation is to issue 1,400,000 shares of stock and sell the same to stockholders of Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2 for each share of Reading stock (Plan as modified, par. 5; Transcript, p. 275).

In short, the interest of Reading Company in the Coal Company, through the medium of a new corporation, is to be distributed *pro rata* to its stockholders, preferred and common, share and share alike, upon payment by them of \$2 for each of their shares in Reading Company, and, as the result of this, the corporate surplus of Reading Company is to be depleted to the extent of \$38,000,000.

If the actual value of the interest of Reading Company in the Coal Company (after the delivery by the Coal Company to the Reading Company of \$10,000,000 in cash or current assets and \$25,000,000 in bonds) were no more than the \$5,600,000 for which it is to be offered to the stockholders, preferred and common, share and share alike, the \$38,000,000 would be a legitimate loss that could properly be charged against surplus of the Reading Company. On the other hand, none of the stockholders would receive any benefit whatever from such distribution, because the value of what they receive would be precisely what they pay for it. There would, therefore, be no controversy between the preferred stockholders and the common stockholders, and they would not be before this Court, the preferred stockholders supporting the Plan made mandatory by the decree and the common stockholders attacking it. It follows that, upon the payment of \$2 per share of Reading stock for a *pro rata*

share of the interest of Reading Company in the Coal Company, each stockholder will receive something exceeding \$2 in value, and it follows that the preferred stockholders are supporting the Plan for the purpose of reaping the benefit of such excess value.

The present value of the interest of Reading Company in the Coal Company may be less than the \$78,000,000 at which it is carried on the Reading Company's books, but it is obviously more than the \$5,600,000 for which it is to be sold to the stockholders; so that, while it may not be claimed that the distribution of the interest of the Reading Company in the Coal Company necessarily involves a distribution to its stockholders of the entire \$38,000,000 by which its surplus is depleted, it does affect a distribution to its stockholders of so much of that \$38,000,000 as represents the difference between the value of the interest to be distributed and the \$5,600,000 that is to be paid therefor by its stockholders, and, there being \$70,000,000 of first and second preferred stocks and \$70,000,000 of common stock, it follows that the preferred stockholders will receive one-half of so much of the \$38,000,000 as represents the difference between the value of the interest and the \$5,600,000 that is to be paid therefor.

In its effect, therefore, upon the Reading Company and in its benefits to the stockholders, the disposition of the interest of the Reading Company in the Coal Company is precisely the same as if the Reading Company should pay to its stockholders, preferred and common, share and share alike, a dividend aggregating \$38,000,000, less such part thereof, if any, as may represent the difference between the actual value of the interest of Reading Company in the Coal Company and the value of approximately \$78,000,000 at which that interest is carried on the Reading Company's books. In other words, this disposition is a dividend, although it has been

given the appearance of a sale, and although the appellee Reading Company, in defense of the Plan made mandatory by the decree, has argued indiscriminately that it is a sale, that it is a distribution of a capital asset, and that it is a partial liquidation on partial dissolution, without taking any definite position as to which of the three it claims this distribution to be.

The means by which the Board of Directors of Reading Company have seen fit to bring about this effect cannot change its nature, and it is immaterial that they have given it the appearance of a sale and that they have not given it the name of a dividend. The courts are not influenced by these considerations, but look only to the substance.

In the *City of Allegheny v. Pittsburgh, A. & M. P. Ry. Co.*, discussed *infra*, the distribution by the defendant corporation to its stockholders of the entire capital stock of a controlled corporation was stated by the Pennsylvania Supreme Court to be the severance of the stock from the body of the corporate property; and yet it was held to be a dividend and taxable as such, although it was not called a dividend by the corporation.

In the cases of *United States v. Phellis, Rockefeller v. United States* and *New York Trust Co. v. Edwards*, Nos. 260, 535 and 536, respectively, October Term, 1921, and decided by this Court on November 21, 1921, the distributions to the stockholders represented the proceeds of the disposition of physical properties which the corporations had actually owned and operated. In the *Phellis* case the corporation had disposed of all of its assets and good will, and in the *Rockefeller* and *New York Trust Company* cases each of the corporations had disposed of the assets and good will connected with an important part of its business. The Reading Company has never owned and operated any physical properties, as had all of the corporations involved in the foregoing cases, and has

never engaged in the coal and railway business, as the Prairie Oil & Gas Company and the Ohio Oil Company, in the *Rockefeller* and *New York Trust Company* cases, had engaged in the oil and pipe line business. All that Reading Company has done since 1896 is to hold the entire capital stocks of a coal company and a railway company, the holding jointly of which has been declared by this Court to be unlawful and the acquisition of which was possible only by reason of the broad provisions of the charter of the Reading Company which gave it "the power to make purchases and sales of or investments in the bonds and securities of other companies". Nevertheless, in the foregoing cases this Court, after stating that each of the corporations had an excess of assets over liabilities showing a large surplus of accumulated profits, and after observing that the amount was not important, except that it was sufficient to cover the distributions to its stockholders that grew out of the disposition of the physical properties mentioned, declared the distributions to be dividends and taxable as income to the stockholders who received them.

VIII.

The holders of the preferred stock of Reading Company are entitled to non-cumulative dividends not exceeding four per cent. per annum, and no more.

As already explained, the contract among the stockholders and Reading Company is not set out, either in whole or in part, in the charter of the Reading Company, and must be found in the stock certificates (Transcript, pp. 88, 90, 92).

If there had been any previous negotiations, they would all be merged in the certificates, which must be taken to express the final intention (*Scott v. B. & O. R. Co.*, 93 Md. 475, at p. 498; 49 Atl. Rep. 327, at p. 328).

A. The Reading Company Stock Certificates.

The Reading Company stock certificates were not loosely drawn, but were prepared, as analysis discloses, with the greatest care, and with the intent not only to limit but to protect the preferred stocks in accordance with the understanding, and also to protect and limit the common stock.

The preferred stocks are

“entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on”

the common stock.

In order to make it doubly sure that the above limitation was effective, the certificate then used this language:

“but only from undivided net profits of the company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom.”

The certificate of the first preferred stock provided that, at any time after dividends at the rate of four per cent. per annum should have been paid thereon for two successive years, the Reading Company might, without further consent from the holders or owners thereof, increase and issue first preferred stock to the extent of 420,000 shares for use towards the conversion of the second preferred stock; and the certificate of the second preferred stock provided that, at any time after dividends at the rate of four per cent. per annum should have been

paid for two successive years on the first preferred stock, the Reading Company, without further consent from the holder or owner of the second preferred stock, might exercise the right to convert the second preferred stock, not exceeding \$42,000,000 at par, one-half into first preferred stock and one-half into common stock. Both certificates provided that the Reading Company should have the right at any time to redeem either or both classes of the preferred stock, at par in cash, if such redemption should then be allowed by law.

By conversion of the second preferred into half first preferred and half common, or by redemption of either class or both classes of preferred stock, the common stock, which at the organization of the company was equal in amount to the two preferred stocks, might easily come into control of the Board. Under those circumstances, unless there were ample protection thrown around the preferred stocks, and proper limitations placed upon the common stock, the preferred stocks might, by the accumulation of earnings for a period of years and then an extraordinary dividend to the common stock, be unfairly deprived of their share of the net profits. That share was to be 4% per annum "when and as determined by the Board of Directors, and only if and when the Board shall declare dividends" from the net profits, "but not exceeding four per cent". It did not cumulate, however; so that, if the company were not successful, the preferred stocks were obliged to share the misfortunes with the common stock. On the other hand, the company might be highly successful, and with the common stock in control might not pay the preferred dividends, the common stock, for the time being, foregoing its own dividends, biding its time, and then in some later year declaring a 4% dividend to the preferred stocks and an extraordinary dividend from the accumulated earnings to the common stock.

To guard against that possibility, the certificates were carefully worded in such a way as to force the common stock to declare the preferred stock dividends if they were earned. This wording, as it appears in the common stock certificates, which follows exactly the certificates of the first and second preferred stocks, with appropriate changes, is as follows:

"If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the first and second preferred stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the first and second preferred stock."

Under these provisions, if full dividends on the preferred stocks were earned, but were not paid, not only was the common stock deprived of dividends in that year, but it was also deprived of the opportunity to declare out of such accumulated net profits a dividend to itself in the subsequent year. Having, however, in any particular year paid the full dividends to the preferred stocks out of the net earnings of that year, there is nothing to prevent the common stock from leaving the surplus in the treasury of the company for such declaration of dividends to the common stock in the future as the company may determine.

An illustration in figures will be helpful. The preferred stocks as issued aggregated \$70,000,000, and 4% thereon required \$2,800,000 annually. Assume during the first year of its history the company earned \$5,000,000 and paid no dividends on any stock. During the second

year it earned \$2,800,000. It might pay dividends on the preferred stocks up to, but not exceeding, 4%, or \$2,800,000. The first year's earnings, \$5,000,000, could not be applied to the payment of 4% on the preferred stocks in respect of the first year, since the preferred stocks are non-cumulative.

The effect of this would be to induce the common stockholders to cause the preferred dividends to be paid each year, because, if they had been paid in the first year, then there would have been \$2,200,000 available for the common stock then or in any subsequent year, but, as they were not paid, the common stock would lose the right in any subsequent year to receive a dividend from such \$2,200,000.

The effect of this is, furthermore, that the preferred stocks, being limited to 4%, must, nevertheless, get that 4% in each year, or else an amount equal to the net profits of that year becomes a working surplus or a segregated working fund against corporate misfortunes. But if the common stock treats the preferred stocks fairly, and pays them their full dividends, it may draw dividends at once or not, as it sees fit and at any time it sees fit.

That has been the history of the Reading Company. Beginning with dividends on the first preferred stock in 1900, soon after its reorganization, it worked them up to a 4% basis in 1903, and has thereafter paid the full dividend on the first preferred stock. It began in 1903 to pay dividends on the second preferred stock, and since then has paid those dividends in full. It then began to pay dividends on the common stock in 1905, and, beginning in 1913, and ever since, has paid dividends at the rate of 8% on the common stock (Transcript, pp. 103, 104).

And so since 1904, when Reading Company began to pay full dividends on both preferred stocks, all of the earnings over preferred dividends might have been distributed to the common stock, as the Board of Directors might declare at any time.

The preferred and common stocks, therefore, both share in the vicissitudes of the company. If the company was unsuccessful, no claims of the preferred stocks for accumulated dividends piled up against future success; and yet, if the company was successful, no machinations of the common stock, in case it should come into control, could preclude the preferred stocks from receiving their full 4% dividends while the company was piling up a surplus for future distribution to the common stock.

B. The Preferred Stock Certificates.

It is submitted that the foregoing discussion correctly states the purposes that were in view when the certificates were prepared, and places upon the terms of the stock certificates the only natural and satisfactory construction that may be placed upon them, and that this construction is fully borne out, not only by the circumstances and conditions with reference to which the certificates were drawn, but also by the conduct of Reading Company in declaring all dividends that have been declared and paid upon each class of stock of Reading Company. In the proceedings below attempts were made to place other constructions upon the stock certificates, and the appellee Reading Company argued that non-cumulative dividends, at the rate of, but not exceeding, 4% per annum in each and every fiscal year, are not the absolute limit of the rights of the preferred stocks.

Abandoning the pretense that the disposition of the interest of Reading Company in the Coal Company required by the decree is a sale, or is a distribution of a capital asset, or is a partial liquidation on partial dissolution, appellee Reading Company in its answer and cross petition (Subd. IX, Transcript, pp. 173-180) deals with this disposition according to its real nature—that is, as a disposition of accumulated surplus—and undertakes to show that, by reason of the extraordinary nature

of such disposition, the preferred stocks are entitled to share therein equally with the common stock under the terms of the preferred stock certificates.

This calls for a further discussion with reference to the authorities.

In *St. John v. Erie Ry. Co.*, 22 Wallace, 136, the agreement provided that

"Said preferred stock shall be entitled to preferred dividends out of the net earnings of said road (if earned in the current year, but not otherwise), not to exceed 7% in any one year, payable semi-annually after payment of mortgage interest and delayed coupons in full."

Commenting upon this provision, this Court said (at p. 147) :

"The maximum payable on the preferred stock was specified. It might be less, or nothing. It could not be more. The amount subject to the limit prescribed depended wholly on the residue of the net earnings applicable in that way. The language employed is apt to express the relation of stockholders."

In *Scott v. B. & O. R. Co.*, 93 Md. 475, 49 Atl. Rep. 327, the meaning of the preference to the stockholders of that Railroad was examined exhaustively. The stock certificates set out the agreement as follows :

"The holders of preferred stock to the amount now issued, and such additional amounts as may be lawfully issued from time to time by the President and Directors of the Company pursuant to the resolutions of the stockholders duly adopted April 11, 1899, are entitled to receive in each year, out of the surplus net profits of the Company for the current year, such yearly dividend (non-cumulative) as the Board of Directors of said Railroad Company may declare, up to but not exceeding, four per centum, before any dividend shall be set apart or paid upon the common stock."

The contention of the preferred stockholders was that they not only had the right to receive a 4% dividend before any dividend to the common stockholders, but to share *pro rata* with the common in a distribution of the residue, or, as an alternative proposition, to share equally with the common stockholders in any part of the earnings distributable after the payment of a dividend of 4% to both the common and the preferred stockholders.

It will be noted that such preferred stock was the usual 4% non-cumulative railroad stock developed at about the time of the reorganization of the Baltimore & Ohio Railroad Company, which was about the time of the reorganization pursuant to which the Reading stock certificates were issued. The dates of the two reorganizations were not far apart, and the language of the Baltimore & Ohio certificate is strikingly similar to the language of the Reading certificates.

The Court of Appeals of Maryland, after the presentation of the case exhaustively by counsel among the most eminent in the country, decided that the preferred stockholders, after receiving a dividend of 4% in any one year, were not entitled to share with the common stockholders in the distribution of the residue of the net earnings, either equally or after the payment of a like dividend to the common stockholders, but that the preferred stockholders were entitled to a dividend of 4%, and no more, upon the payment of any dividend to the holders of the common stock.

In the disposition by the Union Pacific Railroad Company of its interest in the Southern Pacific Company, the Union Pacific and its counsel were always alive to and observant of the respective rights of their preferred and common stockholders. They made no attempt to dispose of the interest in the Southern Pacific Company through a so-called sale to the stockholders, preferred and common, share and share alike, at a purely arbitrary figure

and grossly inadequate price, and thus permit the preferred stockholders to reap the benefit of the difference between the value of what they received and the price paid for it. Instead, as heretofore pointed out, *the disposition was an actual sale at approximately the market price, and the proceeds of that sale were placed in the treasury of the Union Pacific Railroad Company.* In other words, the method of disposition and the treatment of the proceeds were in accordance with the suggestion for the modification of the Plan made mandatory by the decree that these appellants submitted to the District Court and that is explained at length under III hereof.

After the proceeds had come into the treasury of the Union Pacific Railroad Company, it declared a special dividend of \$80,000,000 payable to the common stock, to the exclusion of the preferred stock.* The Union Pacific stock certificates set out the agreement as follows:

“Such preferred stock shall be entitled, in preference and priority over the common stock of said corporation, to dividends in each and every fiscal year, at such rate, not exceeding four per cent. per annum, payable out of net profits, as shall be declared by the Board of Directors. Such dividends are to be non-cumulative, and the preferred stock is entitled to no other or further share of the profits.”

Thereupon the holder of a large amount of the preferred stock brought an action against the Union Pacific Railroad Company to restrain the payment of this extra dividend to its common stockholders. The controversy was finally determined by the Court of Appeals of the State of New York (*Equitable Life Assurance Society v. Union Pacific R. R. Co.*, 212 N. Y. 360).

The Court, in an exhaustive opinion by Hiscock, J., now Chief Judge, held that the preferred stockholders,

*Of this \$80,000,000, upwards of \$58,000,000 was the profit from the disposition of the interest in the Southern Pacific Company.

having received their 4% dividends, were at an end of their rights so far as profits were concerned.

It has been urged, however, that the rule as announced in *St. John v. Erie Ry. Co.* (*supra*) ; *Scott v. B. & O. R. Co.* (*supra*), and *Equitable Life Assurance Society v. Union Pacific R. Co.* (*supra*) is not the rule in the State of Pennsylvania, and that the Pennsylvania rule is that where in the agreement there is nothing limiting the right of the preferred stockholders to a specified dividend, they are entitled to share with the common stockholders in profits distributed after the latter have received in any year an amount equal to the dividend on the preferred stock. This rule is peculiar to Pennsylvania, and is not sustained in other jurisdictions.

In *Stone v. United States Envelope Co.*, 111 Atl. Rep. 536, the Supreme Judicial Court of Maine had before it a contention of the preferred stockholders that where a preferred stock is created *with no stipulation in reference to participation in surplus*, the balance of the profits, after payment of a 7% dividend to the preferred stock, and perhaps an equal dividend to the common stock, must all go to the stockholders, both preferred and common, without discrimination.

With reference to this, the Court says (p. 537) :

"Both parties present authorities sustaining their respective contentions. There are two opposing theories, each of which has judicial support. One theory is that the preferred stockholder presumptively yields nothing in compensation for the benefits which he receives; that he has and holds all the rights of the common shareholder and in addition has his preferential rights.

* * * * *

The other theory, which we believe to be better and supported by the weight of authority, is that, in receiving the greater security of his preferential rights, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation."

Where, however, the right of the preferred stockholders is limited to a specified dividend, as in the Reading Company stock certificates, the Pennsylvania rule does not operate.* But the appellee Reading Company insists that, despite the fact that its preferred stockholders are limited to a specified dividend, and that the Pennsylvania rule does not apply, the preferred stockholders of Reading Company, on grounds that are common to all jurisdictions, are entitled to participate equally with its common stockholders in the disposition of its interest in the Coal Company, by reason of the fact that the limitation of the preferred stockholders to a specified dividend cannot be applied to this distribution, because its extraordinary nature takes it out of the class of distributions to which this limitation applies. This is set forth in the answer and cross petition of appellee Reading Company, as follows:

"The Reading Company is advised and believes that the holders of the preferred stock are entitled to a preference and are subject to a limitation of four per cent. per annum with respect to dividends from current profits of the Reading Company; but that they are entitled to no preference and are subject to no limitation with respect to distribution either of capital or of accumulations of profits which, for any reason, have become part of the capital or partake of the nature of capital and are not being detached therefrom by any voluntary act of the Company but only by a compulsion that makes such detachment a distribution of assets in partial liquidation of the corporation" (Transcript, p. 174).

*In the proceedings in the District Court a number of Pennsylvania decisions were cited by counsel for the appellee Reading Company and the appellees Adrian Iselin *et al.* and William B. Kurtz *et al.*, representing preferred stockholders. These decisions are not deemed important by these appellants, for the reason that most of them deal with situations where the right of the preferred stockholders was not limited to a specified dividend, thus permitting the Pennsylvania rule to operate, and the others are not in point. As said appellees, however, attach importance to these decisions, they are discussed in Appendix A hereto.

Such a contention is made possible solely by the provisions of the Plan made mandatory by the decree to which these appellants object. If the Plan should be modified in accordance with the suggestions offered by these appellants so as to bring about a *bona fide* sale at approximately market value and the placing of the proceeds of the sale in the treasury of Reading Company, as was done in the *Union Pacific* case, or so as to bring about a *bona fide* disposition of capital assets and the reduction of the capital stock to the extent of the appraised value of those assets, the foregoing contention could not be advanced.

Reading Company is to detach from its assets, and dispose of, its interest in the Coal Company under compulsion of the mandate of this Court, and that is as far as the compulsion goes. The choice of means for disposing of such interest, within limits which are not important in this connection, has been left absolutely to the voluntary act of Reading Company. The answer and cross-petition of Reading Company practically admits this in the following language:

“Though in an important sense compulsory because taken under pressure of necessity created by the decree of this Honorable Court, the plan must be regarded as in some sense also voluntary since it requires corporate action not directly involved in the issues in this cause” (Transcript, p. 155).

But the Reading Company, as its own free and voluntary act, has devised a Plan for such disposition that operates to the prejudice of the rights of the common stockholders, and has endeavored to fasten the responsibility for such prejudice upon the compulsion of the mandate of this Court. In other words, the foregoing contention is based upon a situation that Reading Company has created by its own voluntary act, and it is now attempting to use the situation that it has created as a justification for creating it.

This may, perhaps, be made clearer by pointing out that, if an actual *bona fide* sale at approximately the market value were made of the interest of Reading Company in the Coal Company, no questions involving distribution of capital assets, or partial liquidation on partial dissolution, or extraordinary and compulsory distributions of assets would be involved. There would merely be the sale of an asset and the substitution of its proceeds for the asset itself among the assets of Reading Company, with such charge to surplus, if any, as might be necessary to adjust the difference between the value at which the asset was carried on the books of the Reading Company and the proceeds of its sale. If the Reading Company should make a *bona fide* sale, whether voluntary or by compulsion, of any of its assets, in this case or in any other case, its common stockholders could have no objection to the charge to its surplus of the legitimate loss that would arise under such a sale.

The extraordinary distribution of surplus that is involved in this case, and that is claimed by Reading Company to be outside the specified dividend to which the preferred stocks are limited, has been created artificially by the device in the Plan that is intended to bring about a so-called sale of the interest of Reading Company in the Coal Company at an inadequate price.

It is not conceded, however, that, even if such an extraordinary distribution from surplus as is here involved were made necessary by the mandate of this Court, the limitation of the right of the preferred stockholders to a specified dividend would not apply thereto.

Diligent search has failed to disclose any decisions of the Pennsylvania courts regarding such distributions, except the following:

In *City of Allegheny v. Pittsburgh, A. & M. P. Ry. Co.*, 179 Pa. St. 414; 36 Atl. Rep. 161, the defendant was chartered by a special act by the provisions of which it

was to declare dividends of "so much of the profits of said company as shall appear advisable to the directors thereof", but in no case to exceed the amount of the net profits of the company, and was required also to pay to the City of Allegheny a certain percentage "of the dividends declared". Defendant held certain stock of a second corporation, which was exchanged for stock in a third corporation, and the latter stock was then issued directly to defendant's stockholders. It was held that the transaction was a severance of the stock from the body of the corporate property and a distribution of its value or equivalent among the stockholders individually, and therefore a dividend taxable, unless the legislative intent was to restrict to cash dividends only, the burden of proof of which would be upon the appellant. While this case involved a tax question, and did not deal with the respective rights of preferred and common stockholders, it clearly indicates the view of the Pennsylvania Supreme Court that a dividend made under unusual circumstances, and consisting of assets of a permanent character, is not to be differentiated from any other dividends.

The decisions of courts in other jurisdictions and decisions of the Federal courts are to the effect that the limitation of preferred stock to a specific dividend applies to extraordinary as well as to ordinary distributions from surplus.

In *Equitable Life Assurance Society v. Union Pacific R. R. Co.*, *supra*, Hiscock, J., now Chief Judge, writing for a unanimous Court except one Judge not sitting, says, at page 366:

"When a corporation is organized it secures capital by the issue of shares of capital stock. The fund or property thus secured answers the two-fold purpose of furnishing means for carrying on the operations of the corporation and also security for the payment of creditors. This capital stock is carried as a liability and universally, so far as I am aware,

at its par amount. It is thus carried as a liability because this is the proper bookkeeping entry. But aside from this, such entry also serves to emphasize the duty of the corporation to keep its capital stock unimpaired for the protection of those dealing with it. If the operations of the corporation result in gains, such gains are carried to the credit, not of the capital stock account but of some other account, as surplus or profit and loss. Of course they may be capitalized by the issue of stock against them and sometimes in the cases of certain corporations like banks or insurance corporations where a certain ratio between assets and liabilities other than to capital stock is required, such surplus or profits may be counted and maintained as capital although not formally capitalized.

In the absence of some such special consideration I think we may take notice that it is the ordinary rule of corporate management established by decisions, statutes and business usages that the surplus of these gains or profits beyond what may be necessary to keep good the liability to capital stock which has been issued, may, in the discretion of a board of directors, be distributed amongst its stockholders as dividends and returns on their investment. Such being the general rule, it is incumbent on the plaintiff to show that there is something so peculiar in the two transactions being considered that the profits resulting therefrom are of a different nature in respect of this subject than those ordinarily realized in corporate business, and I think it has failed to do this."

In undertaking to show that there was something so peculiar in the profits realized from the sale of the interest of the Union Pacific in the Southern Pacific, out of which profits the dividend involved had been declared to the common stockholders to the exclusion of the preferred stockholders, that those profits were of a nature different from those ordinarily realized in corporate business, and were not, therefore, subject to the limitation upon the preferred stocks, the plaintiff pointed out that the Union Pacific Railroad Company was not organized to deal in

stocks, and that, therefore, the profits derived from the sale of the Southern Pacific stock which it held among its assets were not profits ordinarily realized in corporate business. The Court held that the profits derived from the sale of the Southern Pacific stock were accumulated profits from surplus, and rejected the proposition that these amounts, because resulting from what was, perhaps, an unusual transaction, were not profits, but, as contended by that plaintiff, an accretion which belonged to capital. The opinion states:

"No case has been cited which in my opinion sustains the proposition that these gains must be treated as an accretion to capital and distributed as such, rather than as profit distributable in the discretion of the directors in dividends."

Much more emphatic is the situation in the instant case. The Union Pacific Railroad Company was and is an operating railroad company. The Reading Company is a proprietary and not an operating company. In the *Equitable-Union Pacific* case it was strenuously contended that the accretion realized from the sale of some stocks which the railroad company had in its treasury could not have been within the contemplation of the railroad's charter, and, therefore, that such profits could not have been in the mind of the preferred shareholders when they agreed to take 4% dividends in full for their share of profits.

But no such contention is tenable here. The corporate powers of Reading Company are practically unlimited, except that it may not have banking privileges or franchises or the privilege of issuing its obligations as money. The assets of Reading Company consist of railroad and floating equipment, which it leases and receives the rentals thereon; of bonds and stocks; of a debt from one of its subsidiaries, the Coal Company; and of cash and other current items. If it acquires a block of stock for a

certain price, and subsequently disposes of it for an increased price, that increase is just as much earnings as though the corporation whose stock was sold had declared a dividend to the Reading Company as stockholder. Its charter gives it the right to acquire, enjoy and dispose of all manner of property, specifically securities.

In the earlier case of *Williams v. Western Union Telegraph Co.*, 93 N. Y. 162, the Court said:

"By loss or misfortune, or misconduct of the managing officers of a corporation, its capital stock may be reduced below the amount limited by its charter; but whatever property it has up to that limit must be regarded as its capital stock. When its property exceeds that limit, then the excess is surplus. Such surplus belongs to the corporation and is a portion of its property, and, in a general sense, may be regarded as a portion of its capital, but in a strictly legal sense it is not a portion of its capital, and is always regarded as surplus profits. The very section we are considering contemplates that there may be a surplus, and that such surplus may be divided. The surplus may be in cash, and then it may be divided in cash; it may be in property, and if the property is so situated that a division thereof among the stockholders is practicable, a dividend in property may be declared, and that may be distributed among stockholders. All such dividends diminish and deplete the property of the corporation, and that section was designed to prevent dividends of property which tended to deplete the assets of the company below the sum limited in its charter as the amount of its capital stock" (at pp. 188, 189).

That case drew no distinction between ordinary and extraordinary distributions, although an extraordinary distribution was there under consideration.

In *Russell v. American Gas & Electric Co.*, 152 App. Div. 136; 136 N. Y. Supp. 602, the Appellate Division of the Supreme Court, for the First Department, had before it the appeal of the holder of 480 shares of the preferred

stock of the defendant corporation, which had an authorized capital stock of \$7,000,000, divided into 140,000 shares, of the par value of \$50 each, one-half of which was preferred and one-half common. There were 36,770 shares of preferred and 20,000 shares of common unissued. The preferred stock was entitled to accumulated dividends at the rate of 6 per cent. per annum and to preference in the distribution of assets until the par value and accumulated dividends had been paid and "to no further dividend or distribution."

The directors of the defendant corporation resolved to issue 10,000 shares of the unissued common stock and to allow the holders of the issued common stock to subscribe for the same, ratably, at par. The market value of the common stock was then about \$80 per share, while that of the preferred was about \$47. The plaintiff demanded that he be allowed to subscribe *pro rata* for the common stock, along with the then holders of common stock. His request was refused and he thereupon commenced his action. The Court below denied his motion for an injunction *pendente lite*, but upon condition that he be allowed to subscribe for an equivalent amount of *preferred stock* at par. He then took this appeal. The Court, after stating the facts as above, said:

"The principal ground of plaintiff's alleged cause of action, as set forth in his complaint, is that the holders of the common stock have been given the right to subscribe, at par, for stock which is worth about thirty dollars more than par, while the same right has not been extended to the holders of the preferred stock. I am unable to see how the plaintiff can maintain his alleged cause of action, or that he has any reason to complain. Where a corporation has property in excess of the amount of its capital stock, the excess is surplus which may be divided among the stockholders entitled to share therein, either in money or property. (*Williams v. Western Union Telegraph Co.*, 93 N. Y. 162.) As a holder of the preferred

stock the plaintiff could claim no interest in such excess. So long as the dividends upon his stock were paid, and the defendant had property equal in value to the amount of its outstanding capital stock, after the payment of its debts, the corporation, if it saw fit to do so, could distribute all the rest of its assets among the holders of its common stock and the plaintiff would have no ground for complaint.

“* * * whatever value the stock had above par represented surplus and was available for distribution among the holders of its common stock. Whether this was done by selling the stock at its market value and then distributing the excess, or by issuing the stock to the holders of the common at par, does not concern the plaintiff. He cannot insist that the corporation build up a large surplus nor object to a distribution of its property, when duly authorized, among the holders of common stock, so long as his dividends are paid and its capital remains unimpaired.

“It is urged, however, and with some force, that the plaintiff, as a stockholder, had the right to share proportionately in any issue of stock * * *. In so far as this contention is based upon plaintiff's asserted right to participate in the profits derived from the issue of the common stock below its market value, it is unsound and cannot be sustained.”

The Court below had given plaintiff the right to subscribe enough *preferred* stock to preserve his proportionate interest in the Company, and this was not disturbed on appeal.

It will be noted that in this case the new stock was to be subscribed for *at par*, and that no encroachment on surplus or distribution of assets was, therefore, involved.

The rule of this case may be stated to be that, so long as his dividends are paid and the capital of the corporation remains unimpaired, a preferred stockholder cannot object to a distribution of its property among the common stockholders. This rule would apply to an extraordinary

distribution out of the surplus, such as the appellee Reading Company claims is not within the limitation of its preferred stock certificates, but it goes even beyond that in excluding the preferred stock from *any benefit* in which the common stock may participate so long as the preferred dividends are paid and the capital of the corporation remains unimpaired.

In *Niles v. Ludlow Valve Mfg. Co.*, 202 Fed. 141, the Board of Directors of the defendant company had determined to make a distribution of accumulated surplus by way of a stock dividend, and the plaintiff, who was administrator and represented 100 shares of preferred stock, insisted that he was entitled to share in this division of accumulated surplus. The preferred stock was entitled to "receive interest or dividends of 8 per cent. per annum and be preferred as to capital as well as to dividends". Dividends had been paid by the defendant corporation for twenty years, and in almost every instance the dividend on the common stock had been larger than on the preferred stock, without any objection on the part of the preferred stockholders, including the plaintiff and his intestate. This is analogous to the history of the Reading Company since 1905.

The opinion states (p. 142) :

"that the question turns upon who owned the \$500,000 accumulated by the defendant prior to the time the stock dividend was declared"

and continues:

"It seems evident that as these profits arose from year to year, the Board of Directors might properly have divided them annually, as dividends, among the common stockholders. We think they might legally have done this, and, if so, it is not easy to understand how the common stockholders lost these rights because the Board reserved the division until the surplus had reached the sum of \$500,000. The fund,

large or small, belonged to the common stockholders and whether they received cash, or certificates which represented cash, is immaterial. These stockholders have the burden of administration upon them; if the corporation is unsuccessful, the loss falls upon them; if successful, they receive the benefits. We think that when the preferred stockholders receive the large interest of 8% provided for in the certificate they receive all to which they are entitled from the income of the corporation * * * Upon what principle of law or equity should they be permitted to share in surplus earned by the corporation when they are exempted from bearing any of the loss incurred? Before a dollar can be paid as a dividend to the common stockholder, the entire 8% must be paid to the preferred stockholders. In addition to these advantages, it is now asserted that though they bear no share of the burden when the business is unsuccessful, they should share equally with the common stockholders when it is prosperous * * * Once admit that the preferred stockholder is entitled to share in the surplus after his preferred dividend is paid, and it follows as an inevitable conclusion that he shares on equal terms with the common stockholder" (at pp. 143, 144).

Whatever may be the rule where there is no limitation in the contract, we know of no authority, and can find none, which holds that anything may be distributed to the preferred stockholders from the surplus of the corporation after they have received their full agreed dividends where the language of the certificate affirmatively provides that such dividends are the limit of their rights.

The stock certificates of the Reading Company do so affirmatively provide in the most exact and emphatic language. The preferred stocks are "entitled to non-cumulative dividends at the rate of, *but not exceeding* four per cent. per annum, in each and every fiscal year". And then, to emphasize the language, the certificate goes

on to provide that such dividends are payable *only* from undivided net profits of the company when and as determined by the Board of Directors and only if and when the Board of Directors shall declare dividends therefrom. The use of the word "only" may quite properly be construed to mean that the undivided net profits of each fiscal year are the sole source to which the preferred stocks may look for even the four per cent. non-cumulative dividends to which they are entitled.

IX.

The holders of the common stock of Reading Company are absolutely entitled to distributions out of surplus net profits of the Reading Company of years other than those for which the full dividends shall not have been paid on the first and second preferred stock.

It has been shown under VIII that the preferred stockholders of Reading Company are absolutely limited to non-cumulative dividends at the rate of, but not exceeding four per cent. per annum in each and every fiscal year, and that there is no foundation in law for the proposition that, when a distribution of surplus is made in an extraordinary amount or under extraordinary conditions, such limitation does not apply to the preferred stocks, and that they are entitled to share therein equally with the common stocks. It follows, therefore, that any distribution from surplus, made after the preferred stock-

holders have received in full the dividends to which they are limited by the certificates, must be made solely to the common stockholders and to the exclusion of the preferred stockholders. And this is fully supported by the authorities that have been reviewed:

St. John v. Erie Railway Co., supra;

Scott v. B. & O. R. Co., supra;

Equitable Life Assurance Society v. Union Pacific R. Co., supra;

Williams v. Western Union Telegraph Co., supra;

Russell v. American Gas & Electric Co., supra;

Niles v. Ludlow Valve Mfg. Co., supra.

The appellee Reading Company in its answer and cross petition, however, insists that

“There is to be no dividend or distribution of the coal stock. The situation is not such as to justify declaring a dividend in respect of the coal stock. No extraordinary dividend has been or will be declared by the Reading Company. The common stockholders cannot force a dividend nor can the sale be treated as if a dividend had been declared” (Transcript, p. 162).

And, further,

“Common stockholders have no right in earnings until that right has been created by the declaration of a dividend and they have no right to require a dividend to be declared in the absence of bad faith on the part of the Board of Directors” (Transcript, p. 165).

And still further,

“If, however, contrary to the views above expressed, the plan were to be regarded as involving a

distribution of surplus, as is contended by the Prosser Committee, the preferred stockholders should not with fairness, and could not rightfully, be excluded from participation in it, because it would be neither a dividend nor a voluntary distribution of current surplus net profits" (Transcript, p. 173).

These appellants concede that the common stockholders have no right to require a dividend to be declared in the absence of bad faith on the part of its Board of Directors. They do insist, however:

1. That the so-called sale of the interest of Reading Company in the Coal Company required by the decree is not, and is not intended to be, a sale in any real sense;

2. That this so-called sale, in its purpose and effect, and in everything but form and name, is, and is intended to be, a dividend or distribution of surplus net profits;

3. That, in substance and in fact, the action of the Board of Directors in presenting and procuring the approval of the Plan pursuant to which the disposition by Reading Company of its interest in the Coal Company is to be made was, and was intended to be, the declaration of a dividend, although it did take, and was intended to take, the form and name of a sale;

4. That, in view of this, the preferred stockholders may not with fairness, and cannot rightfully be permitted to, participate in such distribution;

5. That such action on the part of the Board of Directors of Reading Company was purely voluntary;

6. That there is nothing in the mandate of this Court that interfered with the choice of the Board of Directors of Reading Company as among

(a) Disposing of the interest of Reading Company in the Coal Company by making a *bona fide* sale thereof and placing the proceeds in the corporate treasury.

(b) Distributing such interest as a distribution of capital and reducing the capital stock, preferred and common, share and share alike, by the appraised value of such distribution; and

(c) Distributing such interest to the stockholders as a dividend; and

7. That the Board of Directors of Reading Company having made the choice of distributing its interest in the Coal Company as a dividend, such dividend must be distributed to the holders of common stock, to the exclusion of the preferred stock.

X.

The disposition of the interest of Reading Company in the stock of the Coal Company required by the decree confers upon the holders of the preferred stock of Reading Company a benefit to the prejudice of the legal rights of the holders of the common stock of Reading Company.

Respectfully submitted,

ROBERTS WALKER,

Counsel for Seward Prosser,
Mortimer N. Buckner and
John H. Mason, as a Com-
mittee, etc., Appellants.

J. DUPRATT WHITE,
JOSEPH M. HARTFIELD,
ALLEN McCARTY,
of Counsel.

Appendix A.

PENNSYLVANIA DECISIONS.

In the proceedings in the District Court the following Pennsylvania decisions were cited by counsel for the appellee Reading Company and the appellees Adrian Iselin *et al.* and William B. Kurtz *et al.*, representing preferred stockholders:

North American Mining Co. v. Clarke, 40 Pa. 432 (1861).

In this case the controversy was between the holders of assessable and non-assessable shares of a mining company upon *final liquidation*. The holders of the shares that had been assessed claimed that, under certain provisions of the stock contract providing for refunds of assessments out of surplus, their assessments should be refunded to them, and that the remainder should be distributed to all shares alike. *There was no surplus*, and the Court held that the distribution should be to all shares alike, without reference to the claim of the holders of the assessed shares.

Vinton's Appeal, 99 Pa. 434 (1882).

In this case a gas company sold a part of its corporate property and distributed the proceeds as a dividend. The controversy was between the life tenant and a remainderman of a block of stock over the division of the dividend between them. *No question of the respective rights of preferred and common stockholders was involved.*

Fidelity Trust Co. v. Lehigh Valley R. Co., 215 Pa. 610; 64 Atl. Rep. 829 (1906);
Sternbergh v. Brock, 225 Pa. 279; 74 Atl. Rep. 166 (1909);
Sterling v. H. F. Watson Co., 241 Pa. 105; 88 Atl. Rep. 297;
Englander v. Osborne, 261 Pa. 366; 104 Atl. Rep. 614 (1918).

In each of these cases the preferred stock was *cumulative* and contained no limitation to a specified dividend in each and every fiscal year, such as is contained in the Reading Company preferred stock certificates. Consequently, the controversy between the preferred and common stockholders called for the application by the Court of the rule that is peculiar to Pennsylvania and that has been heretofore discussed.

Pardee v. Harwood Electric Co., 262 Pa. 68; 105 Atl. Rep. 48 (1918).

In this case the holders of the preferred stock were entitled to receive *cumulative* dividends at the rate of 6 per cent. per annum, and the stock contract further provided that dividends at that rate *must* be declared by the Board of Directors, when earned, to the extent of and only from the undivided net earnings in each and every fiscal year in preference and priority to any payment in or for such fiscal year over any dividend on other stock.

The preferred stockholders sought to compel the payment of dividends required by the mandatory provision of the stock contract, but the Court held that the discretion of the directors of the corporation could not be overridden by this mandatory provision. The decision in the case may be summarized as follows:

(1) The owners of the preferred stock in a corporation are stockholders and not creditors;

(2) A public service corporation is not required to declare such dividends as will destroy or impair its efficiency; and

(3) The corporation cannot so contract with the holders of its preferred stock as to destroy its usefulness as a public service corporation.

The foregoing brief summaries of the decisions in these cases are sufficient to make it clear that they have no bearing upon the issues in this appeal.



FILED

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IN THE
SUPREME COURT of the UNITED STATES

WM. R. STANSBURY

CLERK

OCTOBER TERM, 1921
No. 609

CONTINENTAL INSURANCE COMPANY and
FIDELITY-PHENIX FIRE INSURANCE COM-
PANY OF NEW YORK

Appellants

against

READING COMPANY and Others

Appellees

No. 610

SEWARD PROSSER, MORTIMER N. BUCKNER and
JOHN H. MASON, as a Committee, etc.

Appellants

against

READING COMPANY and Others

Appellees

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

**BRIEF FOR READING COMPANY
ON REARGUMENT**

CHARLES HEEBNER
R. C. LEFFINGWELL
WM. CLARKE MASON
L. D. ADKINS
A. I. HENDERSON

Of Counsel



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IN THE
Supreme Court of the United States

OCTOBER TERM, 1921

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APPEALS FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA

**BRIEF FOR READING COMPANY
ON REARGUMENT**

This cause originated as a proceeding by the Govern-
ment of the United States to dissolve the intercorporate
relations existing between the corporate defendants
on the ground that such relations constituted a violation
of the Sherman Anti-Trust Act (26 Stat. 209), and also

of the commodities clause of the Act of Congress of June 29, 1906 (34 Stat. 584, 585) (Record, p. 2).

On April 26, 1920, this Court handed down its opinion (253 U. S. 26), holding that the combination existing and maintained through the Reading Company was unlawful.

References and Designations

The original record in the dissolution proceedings is filed in this Court as Nos. 3 and 4 of October Term, 1919, and is referred to in this brief as the Old Record, to distinguish it from the Record on these appeals.

For convenience the following designations adopted in this Court's opinion (253 U. S. 41) are adopted in this brief:

The present Reading Company is called the Holding Company;

Philadelphia and Reading Railway Company is called Reading Railway Company;

The Philadelphia and Reading Coal and Iron Company is called Reading Coal Company;

The Central Railroad Company of New Jersey is called Central Railroad Company;

The Lehigh and Wilkes-Barre Coal Company is called Wilkes-Barre Coal Company.

The future Reading Company, after its reorganization as a railroad corporation and merger of the Reading Railway Company, as provided in the decree, is called the New Railway Company.

The new corporation which is to acquire the equity in the stock of the Reading Coal Company, as provided in the decree, is called the New Coal Company.

Seward Prosser, Mortimer N. Buckner and John H. Mason as a Committee, etc., appellants, are called the Prosser Committee.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, appellants, are called the Insurance Companies.

Past History

The salient facts of the history of the corporate defendants as found by this Court are stated in the following excerpts from its opinion (253 U. S. 44-51):

"The Philadelphia & Reading Railroad Company was chartered by special act of the Pennsylvania General Assembly in 1833, and it conducted the business of a railroad carrier prosperously for about thirty years, when, as its annual reports show, it embarked upon the policy of attempting to control the anthracite tonnage of the Schuylkill field by acquiring extensive ownership of coal lands. Thus, the report of the Company for 1871 contains the following:

"Up to this time about 70,000 acres of the best anthracite coal lands in Pennsylvania have been acquired and will be held by an auxiliary company, known as the Philadelphia and Reading Coal and Iron Company, of which the Philadelphia and Reading Railroad Company is the only stockholder. The result of this action has been to secure—and attach to the company's railroad—a body of coal land capable of supplying all the coal-tonnage that can possibly be transported over the road for centuries.'

* * * * *

"In the large financial operations incident to the expansion policy thus described, bonds were issued, secured by a mortgage on all of the property of the Reading Railroad Company and of the Reading Coal Company. In 1893 there was default in the payment of interest on these bonds and receivers were appointed who operated both properties until 1896 when they were sold to representatives of the creditors and stockholders of the two companies, and under a scheme of reorganization, the validity of which is assailed in this suit, both properties were transferred to three corporations in the manner now to be described:

"1st. To the Reading *Railway* Company, a corporation newly organized under the laws of Pennsylvania, were allotted about 1,000 miles of the railroad (but none of the equipment) which had been owned or leased by the former Reading *Railroad* Company. The capital stock of this Company was fixed at \$20,000,000 and it issued \$20,000,000 of bonds, all of which were given to the Holding Company.

* * * * *

"2nd. By the decree of sale the Reading Coal and Iron Company was released from its former obligations and to it thus freed the principal part of the property (coal and other), owned by it before the sale, was allotted and re-transferred upon condition, that it would deliver all of its capital stock to the Holding Company, would become co-obligor with that company on bonds to be issued, and would join with it in executing a mortgage for \$135,000,000 on all of its property to secure such bonds.

* * * * *

"3rd. To serve the purposes of the intended Holding Company, a charter granted in 1871 by special act of the General Assembly of Pennsylvania, but unused for twenty years, was utilized. This charter was of the class denominated "omnibus" by the Supreme Court of Pennsylvania, and in terms it authorized the company to engage in, or control, almost any business, other than that of a bank of issue,—this broad charter was the occasion for making use of the company in this enterprise.

* * * * *

"* * * the Holding Company * * * became the owner of the title to railway equipment, real estate, colliers and barges of an estimated value of \$34,400,000; plus all of the capital stock and bonds of the new Railway Company, \$40,000,000; plus all of the capital stock of the Coal Company, \$8,000,000, and a contract by that company to mortgage, for the use of the Holding Company, its entire property; plus other stocks, bonds and mortgages, owned by the former Railroad Company of the estimated value of over \$38,000,000—making a total value, as repre-

sented at the time to the New York Stock Exchange, of \$193,613,000.

"Thus this scheme of reorganization * * * made the Coal Company and the Railway Company mere agents or instrumentalities of the Holding Company—the mining and transportation departments of its business—for producing, purchasing, and selling coal and for transporting it to market. The Reading *Railway* Company and the Reading Coal Company each had thereafter but one stockholder—the Holding Company—and their earnings were to be distributed not in proportion to the shares of their capital stocks, aggregating \$28,000,000, but were to go to the creditors and shareholders of the Holding Company, with its mortgage debt of \$135,000,000 and its capital stock of \$140,000,000. The Holding Company thus served to pool the property, the activities and the profits of the three companies."

* * * * *

"* * *, the Holding Company, in January, 1901, purchased a controlling interest in the capital stock of the Central Railroad Company. When this suit was commenced that company was operating 675 miles of track, over which it carried in 1913, 10,783,000 tons of anthracite,—almost one-half of its total freight traffic. Its capital stock was then \$27,436,000 and its funded debt was \$46,881,000.

"This Central Company owned, at the time, in excess of eleven-twelfths of the capital stock of the Wilkes-Barre Coal Company, with a capital stock of over \$9,000,000 and a funded debt of about \$17,000,000. And that company owned or had leased in excess of 14,000 acres of coal bearing lands—13,000 acres in the Wyoming field—and in the year ending June 30, 1913, it shipped from its lands thus owned or controlled, 6,243,000 tons of coal, which was sold for over \$20,000,000."

The Decision of this Court

This Court found that the Holding Company was in active, dominating control of the Reading Railway Company and of the competing Central Railroad system, and also of the two coal companies, the Reading Coal Company

and the Wilkes-Barre Coal Company, and that the combination thus maintained constituted a violation of the Anti-Trust Act and fell within the condemnation of the commodities clause. (253 U. S. 59-63.)

Accordingly this Court directed the District Court to enter a decree

"dissolving the combination of the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh and Wilkes-Barre Coal Company, held by the Central Railroad Company of New Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all of these now combined companies may be conducted in harmony with the law."

The Interlocutory Decree of the District Court

The Mandate of this Court was filed in the District Court on August 13, 1920 (Record, p. 27), and thereafter on October 8, 1920, the District Court entered a Decree on Mandate (Record, p. 31), which among other things ordered that

"the defendants shall submit to this Court a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia &

Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law." (Record, p. 36.)

The Situation at the Time of the Interlocutory Decree

The Holding Company has a special charter under the laws of Pennsylvania granted prior to the adoption of the Constitution of 1874, with particularly broad powers. Copies of its charter, and of the charter of the Pennsylvania Company therein incorporated by reference, are printed in the Record, pp. 189-197. The Holding Company is not a common carrier and is not subject to regulation by Federal or State authorities having jurisdiction over railroads. The Holding Company owned:

(a) \$42,481,700 par value, being the entire capital stock (Record, p. 157), and \$20,000,000 bonds (Record, p. 114), of the Reading Railway Company;

(b) \$8,000,000 par value, being the entire capital stock of the Reading Coal Company (Record, p. 157);

(c) real estate, rolling stock and floating equipment used upon or in connection with the Reading railway system (Record, p. 200);

(d) shares of stock and bonds of other railroads and terminal companies constituting part of the Reading railway system (Record, pp. 200, 232; Old Record, pp. 1298-1300);

(e) the entire capital stock of the Reading Iron Company par value, \$1,000,000 (estimated value according to Moody's market letter, \$22,791,500, Record, pp. 123, 232);

(f) \$14,504,000, par value, being more than a majority of the stock of the Central Railroad Company. All the stock of the Central Railroad Company (except 40 shares) owned by the Holding Company is pledged under the Collateral Trust Mortgage of the Holding Company to the Pennsylvania Company for Insurances on Lives and Granting Annuities, Trustee, dated April 1, 1901. The bonds issued by the Holding Company under this mortgage bear interest at 4%, mature April 1, 1951, and are redeemable before maturity at 105 per cent. of the par value thereof and accrued interest. Bonds to the amount of \$23,000,000 are issued and outstanding (Record, p. 158).

The Central Railroad Company owned more than ninety per cent. of the capital stock of the Wilkes-Barre Coal Company. (Record, p. 23.)

The issued and outstanding capital stock of the Holding Company is as follows (Record, p. 157) :

4% non-cumulative First Preferred Stock	\$28,000,000.00
4% non-cumulative Second Preferred Stock	42,000,000.00
<hr/>	
Total Preferred Stock	\$70,000,000.00
Common Stock	70,000,000.00
<hr/>	
Total Capital Stock	\$140,000,000.00

The preferred stock has full voting power (Record, p. 181). The stock certificates are set out in full in the Record, pp. 82-93. There is no material difference between the certificates originally issued at the time of the reorganization in 1896, set out on pages 82-87 of the Record, and the certificates now in use, set out on pages 88-93, nor, for

the purposes of these appeals, between the first and second preferred stocks.

The Holding Company and the Reading Coal Company are joint obligors under the General Mortgage to Central (now Central Union) Trust Company of New York, Trustee, dated January 5, 1897 (hereinafter called the General Mortgage). The General Mortgage Bonds mature January 5, 1997, bear interest at 4%, and are the joint obligations of the two companies. They are not subject to redemption before maturity. Bonds to the amount of \$96,-524,000 (including \$2,831,000 in the Treasury) were outstanding December 31, 1919, and on December 31, 1920, there were outstanding \$95,980,000 of which \$2,711,000 were in the Treasury of the Holding Company. The properties mortgaged and pledged under the General Mortgage include the properties of the Reading Coal Company, the railroad equipment and certain real estate owned by the Holding Company, all the stock of the Reading Coal Company and of the Reading Railway Company, and certain bonds of the Railway Company. (Record, pp. 157, 158.)

The Holding Company had also issued and outstanding equipment trust obligations and other bonds, its total funded debt on December 31, 1920, amounting to \$132,-56,015.28 (Record, p. 200).

The Original Plan

Pursuant to the interlocutory decree of the District Court, the following plan was filed on February 14, 1921 (Record, pp. 40-45) :

"1. The Reading Company will assume the \$96,-524,000 General Mortgage 4% bonds, which are a joint obligation of the Reading Company and The Philadelphia & Reading Coal & Iron Company (hereinafter called the Coal Company), and will agree to save the Coal Company and its property harmless therefrom.

"2. The Coal Company will pay to the Reading Company \$10,000,000 in cash, or current assets at market value, and \$25,000,000 in 4% mortgage bonds of the Coal Company. The mortgage under which they are to be issued may contain provision for the issue thereunder of additional bonds to provide for additions, betterments and improvements to a limited amount, to be determined by the Reading Company and the Coal Company prior to the creation of the mortgage, and shall contain provision for a proper sinking fund for the retirement of bonds issued thereunder. The \$25,000,000 bonds issued by the Coal Company to the Reading Company shall mature on January 1, 1997, the same date as the General Mortgage bonds. The bonds issued by the Coal Company shall be subject to redemption at par and accrued interest on any semi-annual interest date as a whole but not in part, except out of the moneys in the sinking fund.

"3. Except as otherwise herein expressly provided, general releases of all claims and liabilities as between the Reading Company and the Coal Company, including the claim of approximately \$70,000,000 carried on the books of the Reading Company as an asset and on the books of the Coal Company as a liability, will be exchanged.

"4. The Reading Company will agree that it will obtain the release of the coal property from the lien of the General Mortgage and the discharge of the Coal Company from liability on the General Mortgage bonds, provided such release and discharge can be secured by payment by the Reading Company to the bondholders of a premium not exceeding 10% upon the par value of the outstanding General Mortgage bonds. Such release and payment will be made from time to time as the acquiescence of the several bondholders shall be given. The Reading Company will make payment of said premium on the order of the committee to be formed in the interest of the bondholders. Said committee will call for the deposit of bonds and will be authorized by the depositors to return to them their bonds stamped as assenting to the release and dis-

charge above mentioned, or to return to them, in the discretion of the committee, refunding and improvement mortgage bonds of the Reading Company hereinafter described for an equal principal amount and bearing 4% interest. Though the committee will order payment of the premium from time to time as the bonds are deposited, it will, in the first instance, cause to be issued depository receipts for the General Mortgage bonds and will retain the General Mortgage bonds until it shall have determined that a sufficient percentage of bonds has been deposited to declare in effect the plan of exchange for refunding and improvement mortgage bonds, or that in its judgment it is improbable that a sufficient amount of bonds will be so deposited. Upon such determination it shall deliver to the holders of the depository receipts the refunding and improvement mortgage bonds or General Mortgage bonds stamped as aforesaid, as the case may be. The depository will collect and pay out the interest on the deposited bonds pending the determination of the committee as aforesaid.

"5. It is assumed that the Attorney General will ask the Court to direct the release of the stock of the Coal Company from the lien of the General Mortgage on such terms as the Court may fix. If practicable the Coal Company will consolidate with Delaware Coal Company, of which it owns the entire capital stock, and the consolidated company will issue stock without par value to the Reading Company. If that is not practicable, a new corporation will be created to acquire from the Reading Company the stock of the Coal Company, or the interest of the Reading Company therein, and such new corporation will issue no par value stock. The number of shares to be issued of the consolidated Coal Company or of such new corporation may be 1,400,000.

Such no par value stock will be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each share of Reading Stock. It is proposed to carry out this sale, in accordance with

the precedent established by the Union Pacific Southern Pacific case, by distributing to Reading stockholders assignable certificates of interest in the Coal Company stock exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of Reading Company. Any further steps, which may be deemed necessary by the Court, will be taken to the end that an independent board and management to be approved by it will be maintained for the Coal Company, so that the independence of this company need not await the necessarily gradual process of the distribution of the stock of the Coal Company among persons not holders of stock in the Reading Company.

"6. The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage. The name of the Reading Company, after merger, will not be changed. The Reading Company will accept the Pennsylvania Constitution of 1874, and it will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated.

"7. If and whenever the General Mortgage bondholders' committee shall determine to declare the plan of exchange effective, the Reading Company shall execute a refunding and improvement mortgage, which shall constitute a direct lien upon all the railroads, railroad property, railroad equipment and railroad stocks and bonds then owned by the Reading Company or thereafter acquired by means of bonds issued thereunder. Deposited General Mortgage bonds will be kept alive under said re-

funding and improvement mortgage until the General Mortgage is released. The refunding and improvement mortgage will contain appropriate provision for the reservation of bonds to refund outstanding General Mortgage bonds and other prior lien bonds or obligations. It will be an open mortgage in modern form with appropriate provision for the issue of additional bonds for the acquisition of new property and for additions, betterments and improvements to the mortgaged property.

"8. The Court will be asked to defer the actual sale of the stock held by the Reading Company in the Central Railroad of New Jersey pending the grouping of railroads by the Interstate Commerce Commission under the Transportation Act, but subject to the further order of the Court. It is assumed that the Attorney General will ask the Court to make an order assuring the voting of the stock pending such sale in the manner approved by the Court. A detailed plan for the prompt disposition of the stock of the Lehigh and Wilkes-Barre Coal Company by the Central Railroad of New Jersey has been submitted separately."

Proceedings in the District Court

The Original Plan, having been prepared in consultation with counsel for the Government, and after consultation from time to time with the District Court (Record, p. 278), was approved by the then Attorney General of the United States, except as to the disposition to be made of the stock of the Central Railroad Company (Record, p. 45).

The District Court ordered that the Original Plan and the suggestions of the United States relating thereto be served upon the Central Union Trust Company of New York, Trustee under the General Mortgage, and be open to the inspection of all stockholders; and set March 1, 1921, for a further hearing on the proposed Plan (Record, p. 46).

On March 1, 1921, a supplemental bill was filed by the United States to make the Central Union Trust Company of New York, as Trustee under the General Mortgage, a party to this cause (Record, p. 48).

On March 15, 1921, petitions for leave to intervene were filed by or on behalf of numerous stockholders and by holders of \$3,056,000 General Mortgage Bonds pursuant to oral order of the Court at the hearing on March 1, 1921 (Record, pp. 51-148).

The Insurance Companies, appellants (in addition to the objection to the participation of the preferred stockholders in the coal rights which is the basis of their appeals), objected to the provisions of paragraphs 4 and 5 of the Original Plan, which contemplated the ultimate release of the coal property and the immediate release of the stock of the Reading Coal Company from the lien of the General Mortgage and the payment of not to exceed \$9,400,000 to the bondholders for the release of the property (Record, pp. 70-76).

The Central Union Trust Company of New York, as Trustee under the General Mortgage, filed an answer in which, among other things, it alleged that it was not necessary that the General Mortgage, or the lien thereof, should in any wise be disturbed in order fully to carry out and comply with the Mandate of this Court, and that in this action the Court was without power to disturb the same (Record, pp. 150-152).

By orders filed April 12, 1921 (Record, pp. 203-207), the District Court granted leave to petitioning stockholders and General Mortgage bondholders to intervene, directed that the Central Union Trust Company of New York, Trustee, be made a party defendant and set down for argument on May 2, 1921, the following questions (Record, p. 206) :

"(1) (a) Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the

stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

"(2) Whether the stock of the Coal Company should be sold free from the lien of the General Mortgage, or whether a sale of Certificates of Interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

"(3) Whether the Reading Company should offer a premium of ten per cent. to the General Mortgage bondholders for release of the Coal Company's property from the lien of the mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause."

Modifications of the Original Plan

At the hearing on May 2, 1921, the Holding Company, with the approval of the Attorney-General of the United States, submitted, in open court, modifications of the Original Plan, which met the objections of the bondholders and the Trustee under the General Mortgage (Record, p. 290). Such modifications were thereafter, in pursuance of the direction of the District Court at the hearing on May 2, 1921, reduced to writing by the Holding Company and the Attorney-General of the United States and filed in the District Court on May 12, 1921. (Record, pp. 210, 290.)

The effect of the Modifications was, briefly, to eliminate (1) the provision of paragraph 4 of the Original Plan looking towards the release of the coal property in con-

sideration of a premium of 10% payable to General Mortgage Bondholders, and (2) the provision of paragraph 5 of the Original Plan for the immediate release of the stock of the Reading Coal Company from the General Mortgage.

The modifications filed are as follows (Record, p. 210):

"Paragraph numbered 4 of the Plan as modified will read as follows:

"4. The Reading Company will agree with the Coal Company that, at or before the maturity of the General Mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the General Mortgage and the discharge of the Coal Company from liability on the General Mortgage bonds.

"Paragraph numbered 5 of the Plan as modified will read as follows:

"5. If the Court so orders, the Reading Company will, subject to the lien of the General Mortgage, sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company, including the present right to vote and receive dividends thereon, to a new corporation to be formed with appropriate powers, and will agree to save the new corporation and said stock harmless from the lien of the General Mortgage, and will agree to obtain, at or before the maturity of the General Mortgage, the release of the stock of the Coal Company from the lien of the General Mortgage and the assignment, transfer and delivery of said stock to the new corporation—all in consideration of the payment by the new corporation to the Reading Company of the sum of \$5,600,000 and its agreement to issue its shares to the stockholders of the Reading Company as hereinafter provided.

"The new corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each share of Reading stock. Provi-

sion will be made for the disposition by the Reading Company of any rights to subscribe which may not be availed of by the Reading stockholders within such period as may be fixed by the Court, to the end that the new corporation shall receive the full purchase price of \$5,600,000. It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific-Southern Pacific case, by issuing to Reading stockholders, with or without the intervention of a trustee, as may be provided for in the final decree of the Court, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company.

"In addition there will be embodied in the final decree a permanent injunction against the new corporation exercising its voting power on the stock of the Coal Company in such a way as to bring about any new relations between the Coal Company and the Reading Company of the character complained of in the present suit. Any further steps, which may be deemed necessary by the Court, will be taken to the end that an independent board and management to be approved by it will be maintained for the Coal Company, so that the independence of this Company need not await the necessarily gradual process of the distribution of the no par value stock of the new corporation among persons not holders of stock in the Reading Company.

"The final decree may provide that if by reason of default on the General Mortgage bonds the Trustee, the Central Union Trust Company, shall exercise the right to vote the stock of Reading Coal Company, it shall so exercise that right as not to bring about unity of management between said Coal Company and Reading Company; and the final decree may further provide that, in the event the Trustee at any time is obliged to sell the stock or properties of Reading Coal Company, it shall dispose of such stock and properties separately from the properties of Reading Company and to different interests.

"Paragraph numbered 7 of the Plan will be omitted. Paragraph numbered 8 of the Plan will be numbered 7."

The Modified Plan, having been prepared in consultation with counsel for the Government, and after consultation from time to time with the District Court (Record, p. 278) was approved by the present Attorney General of the United States, except as to the disposition to be made of the stock of the Central Railroad Company (Record, p. 277).

The Final Decree of the District Court

On May 21, 1921, the District Court (Buffington, Davis and Thompson, JJ., sitting under the Expediting Act so-called) rendered an opinion unanimously approving the Modified Plan (Record, pp. 278-286), and on June 6, 1921, entered a Final Decree in accordance with that opinion (Record, pp. 287-312).

Summary of the Modified Plan

The Modified Plan as supplemented by the Final Decree may be summarized as follows:

(a) *The relation between the Holding Company and the Reading Coal Company.* The Holding Company will assume the \$96,524,000 General Mortgage 4% Bonds (\$93,269,000 after deducting bonds in the Treasury) which are the joint obligation of the Holding Company and the Reading Coal Company, and will agree to save the Reading Coal Company and its property harmless therefrom. The Holding Company will receive from the Reading Coal Company \$10,000,000 in cash or cash assets and \$25,000,000 in 4% Mortgage Bonds of the Reading Coal Company, and will exchange general releases with the Reading Coal Company (Record, p. 274). The Holding Company owns all the stock (par value \$8,000,000) of the Reading Coal

Company, subject to the lien of the General Mortgage (Record, p. 157). The Holding Company will, subject to the lien of the General Mortgage, sell its interest in the stock of the Reading Coal Company, including the present right to vote and receive dividends thereon, to the New Coal Company (a new corporation created by the Court's order, of which the Court will retain control so as to prevent its being used to thwart the decree), for \$5,600,000, and the New Coal Company's agreement to issue its shares as follows (Record, pp. 275, 284). The stock of the New Coal Company (1,400,000 shares without par value) will be issued to a trustee or trustees appointed by the District Court, who will issue assignable certificates of interest in the stock of the New Coal Company, exchangeable for such stock only when accompanied by an affidavit stating among other things that the holder is not the owner of any stock of the Holding Company. These certificates of interest will be offered for sale to the stockholders of the Holding Company, preferred and common, share and share alike, for \$5,600,000 or \$2 for each share of stock of the Holding Company (Record, p. 275). Stockholders of the Holding Company cannot, however, continue stockholders of the Holding Company and become stockholders of the New Coal Company during the conversion period (Record, pp. 295, 302-308).

(b) *The relation between the Holding Company and the Reading Railway Company.* The Holding Company owns all the stock (par value \$42,481,700) and \$20,000,000 bonds of the Reading Railway Company, subject to the lien of the General Mortgage (Record, p. 157). The Holding Company will merge the Reading Railway Company and will subject the railway property to the direct lien of the General Mortgage, will accept the Pennsylvania Constitution of 1874 and proceed under the Pennsylvania Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania.

The resulting company, the New Railway Company, will be in all respects subject to the regulation of State and Federal authorities as a common carrier (Record, pp. 276-277).

(c) *The relation between the Holding Company and the Central Railroad Company.* The Holding Company owned stock of the Central Railroad Company to the par amount of \$14,504,000, constituting more than a majority of its stock, subject to the pledge thereof under the Jersey Central Collateral Trust Mortgage securing bonds to the amount of \$23,000,000 (Record, p. 158). The Holding Company was directed to transfer to Trustees appointed by the District Court, subject to the lien of the Jersey Central Collateral Trust Mortgage, its right, title and interest in the stock of the Central Railroad Company; the final disposition of said stock to be deferred, in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920 (41 Stat. 456, 480), until ordered by said Court (Record, pp. 277, 296-297).

(d) *The relation between the Central Railroad Company and the Wilkes-Barre Coal Company.* The Central Railroad Company was directed to dispose of all the capital stock of the Wilkes-Barre Coal Company owned by it to persons or corporations who are not its own stockholders, or stockholders of either the Holding Company, the Reading Railway Company or the Reading Coal Company, and who previous to or at the time of the purchase shall qualify as purchasers by a duly executed affidavit in one of the forms annexed to the decree (Record, p. 298).

The Appeals from the Final Decree of the District Court

On June 16, 1921, the Insurance Companies and on August 3, 1921, the Prosser Committee, both being or representing intervening common stockholders, appealed from the decree approving the Plan. The Prosser Committee

represents 407,728 shares of common stock of the Holding Company (Record, p. 208), which is less than thirty per cent. of the total common stock (1,400,000 shares) and less than fifteen per cent. of the entire capital stock (2,800,000 shares) of the Holding Company. The Insurance Companies own 8,400 shares of common stock of the Holding Company (Record, p. 208), which is six-tenths of one per cent. of the common stock and three-tenths of one per cent. of the entire capital stock of the Holding Company. The assignments of error are set out in the Record, pages 317-320 and 333-337. The appellants contend that the right to subscribe for the certificates of interest in the stock of the New Coal Company, described in paragraph (a) of the above Summary of the Modified Plan (paragraph five of the Plan—Record, p. 275) belongs to the common stockholders of the Holding Company, and to them alone to the exclusion of preferred stockholders. The Holding Company believes that the right to subscribe was properly accorded to all stockholders, share and share alike. This is the only issue presented by these appeals.

The Order for Reargument

These appeals were argued before this Court January 16, 1922, and thereafter on February 27, 1922, the following order of this Court was entered:

"IT IS ORDERED BY THE COURT that these cases be restored to the docket for reargument and assigned for hearing as the first cases for April 10th next, on the question whether the decree in the District Court, in which these are appeals, is in conformity with the opinion of this Court in *United States v. Reading Company*, 253 U. S. 26, and that the Attorney General be advised of this order."

Under date of March 14, 1922, following a request of counsel, the Clerk of this Court notified counsel that the Court desires special attention to be given in the reargument to the following questions:

"1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this Court.

"2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for sale of the Coal Company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage.

"3. Whether compliance with the decree will confer on any one class of stockholders of the Reading Company any benefit to the prejudice of the rights of any other class of stockholders.

"4. What the basis is upon which the amount and character of the payments to be made by the Coal Company and by the new Company to the Reading Company was arrived at, and what the reasons are for adopting it."

ARGUMENT**I**

The decree of the District Court is in conformity with the opinion of this Court in *United States v. Reading Company*, 253 U. S. 26.

This Court directed that the combination of the Holding Company, the Reading Railway Company, the Reading Coal Company, the Central Railroad Company and the Wilkes-Barre Coal Company, existing and maintained through the Holding Company, be dissolved. It directed that such provision be made for the disposition of the shares of stock and bonds and other property of the various companies held by the Holding Company as might be necessary to establish the entire independence from that Company and from each other of the Reading Railway Company, the Reading Coal Company, the Central Railroad Company, and the Wilkes-Barre Coal Company. It directed that such disposition be made of the stocks and bonds of the Wilkes-Barre Coal Company held by the Central Railroad Company as might be necessary to establish entire independence between these two companies. It directed that all these things be done, to the end that the affairs of all of these now combined companies might be conducted in harmony with the law. (253 U. S. 64).

The combination to be dissolved is one "existing and maintained through the Holding Company." This combination existed and was maintained by the Holding Company by ownership of the entire capital stock of the Reading Railway Company, of the entire capital stock of the Reading Coal Company, of more than a majority of the capital stock of the Central Railroad Company, and by the latter's ownership of more than ninety per cent. of the stock of the Wilkes-Barre Coal Company.

The decree of the District Court does dissolve the unlawful combination so existing and maintained. It does contain provision for such disposition of the shares of

stock and bonds and other property of the various companies held by the Holding Company and of the Wilkes-Barre Company held by the Central Railroad Company and is necessary to establish their entire independence from the Holding Company and from each other.

The decree of the District Court goes further than that. Not content with establishing independence between these combined companies it undertakes, so far as the basic combination of the Reading Railway Company and the Reading Coal Company is concerned, not merely to establish independence, but to perpetuate it by vesting control of the Reading Coal Company in the New Coal Company, a creature of the Court.

II

The disposition by the Holding Company of the stock of the Reading Coal Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Holding Company and the New Railway Company, on the one hand, and the Reading Coal Company and the New Coal Company, on the other, as is required by the opinion and judgment of this Court.

The decree disposes of the Holding Company's equity in the stock of the Reading Coal Company to a New Coal Company, the creature of the Court; and disposes of the stock of the New Coal Company to persons not themselves owners of stock in the Holding Company.

The final decree of the District Court provides (Record, p. 292) :

"c. The stock of the new corporation [the New Coal Company] shall be issued to a Trustee or Trustees appointed by the Court. Such Trustee or Trustees shall issue certificates of interest therein as contemplated by the Modified Plan and as hereinafter provided. The Reading Company [the

Holding Company] shall offer such certificates of interest for subscription to its stockholders, preferred and common, share and share alike, and may issue to them assignable warrants evidencing their right to subscribe for said certificates of interest. Neither the defendant Reading Company nor any corporation controlled by it nor any person acting in its interest shall acquire by purchase or otherwise any of said certificates of interest. Such certificates of interest shall be delivered to the subscribers therefor upon payment in full of the subscription price and compliance in all respects with the terms prescribed in the offer. All such certificates shall be registered by the Trustee or Trustees in the names of the purchasers. They shall be substantially in the form hereto annexed marked "Form A." [Record, p. 302.]

"d. The Trustee or Trustees shall be entitled and it shall be their duty, to vote or issue proxies for voting in respect of any and all of said shares of the new corporation held by the said Trustee or Trustees unless otherwise hereafter directed by this Court.

"e. The Trustee or Trustees shall collect and receive any and all cash dividends paid on the stock of the new corporation held by the Trustee or Trustees. Upon the exchange, as hereinafter set forth, of any certificate of interest for shares of capital stock of the new corporation held by the Trustee or Trustees, the Trustee or Trustees shall pay in cash to the owner of the certificate of interest so exchanged or upon his order the amount of all cash dividends collected by the Trustee or Trustees, in respect of the number of shares represented by such certificate of interest, but without interest thereon, and shall execute and deliver to such owner or upon his order a dividend order or assignment for the amount of any dividends declared but not then payable in respect of shares vested at the time of such exchange in the Trustee or Trustees as the registered stockholder entitled thereto. Any interest realized or allowed by the Trustee or Trustees upon funds paid to the Trustee or Trustees as dividends shall be applicable to the payment of the compensation of the Trustee or

Trustees and the expenses of the administration of the trust, and any balance thereof remaining shall be paid to the defendant Reading Company unless otherwise ordered by the Court.

"All dividends payable otherwise than in cash which shall be declared by the new corporation shall ~~be~~ received and held by the Trustee or Trustees for the *pro-rata* benefit of said registered owners, from time to time, of the certificates of interest, upon the same terms and conditions as the shares originally deposited, and shall be distributed to the persons who shall be the respective owners of the certificates of interest when and as, and only when and as, the shares originally deposited are distributed to them respectively, subject to any necessary adjustment by scrip or otherwise, in the discretion of the Trustee or Trustees, in respect of fractional shares.

"No deduction shall be made by the Trustee or Trustees in the distribution of such dividends or subscription rights for any commissions or expenses of the Trustee or other costs of collection or payment.

"f. Upon surrender of any outstanding certificates of interest by the registered owner thereof or his assignee, the Trustee or Trustees shall deliver to him stock certificates for the number of shares of the new corporation represented by the surrendered certificate of interest, which stock certificates shall be issued by the new corporation and registered on its books in the name of the new holder, upon condition, however, that the applicant for such exchange shall file with the Trustee a duly executed affidavit in one of the forms hereto annexed."

The form of affidavit for use by individuals is as follows (Record, p. 305) :

"STATE OF COUNTY OF....., ss.
....., being duly sworn,
deposes and says:

That deponent is a *bona fide* owner in his (or her) proper right of a certificate or certificates of interest numbered for shares registered

in the name of _____ issued by _____
 _____ as Trustee, under a decree entered on
 the _____ day of June, 1921, by the District Court
 of the United States for the Eastern District of
 Pennsylvania, in the suit of the United States of
 America against Reading Company and others, and
 makes this affidavit for the purpose of procuring the
 issue of shares of the capital stock of the

Company held by said Trustee,
 in exchange for said certificate (or certificates) of
 interest. That deponent does not own in his (or
 her) own right any shares of the capital stock of
 the Reading Company, a corporation of the Com-
 monwealth of Pennsylvania, whether registered in
 his (or her) own name on the books of said Read-
 ing Company or registered in the names of others
 for deponent's use and benefit. That deponent, in
 making this application, is not acting for or on be-
 half of any stockholder of the Reading Company, or
 in concert, agreement, or understanding with any
 other person, firm or corporation for the control of
 the _____ Company in the interest of
 the Reading Company, but in his (or her) own be-
 half in good faith.

Sworn to before me this _____ }
 day of _____, 1921. }

Appropriate variations are made in the forms for use
 by corporations, partnerships and trustees (Record, pp.
 306-308).

Under these provisions the stockholders of the Holding
 Company, unless they choose to sell their stock in the
 Holding Company instead, are merely a conduit for the
 sale of the stock of the New Coal Company to others.
 The control of the New Coal Company, and hence of the
 Reading Coal Company, is immediately vested in trustees
 appointed by the District Court, and does not pass from
 them until the certificates of interest which the trustees
 will issue shall have become the property of persons not
 owners of stock in the Holding Company. Holders of

certificates of interest will be under pressure to sell them or their stock in the Holding Company, because they cannot collect dividends, or vote, on the stock of the New Coal Company, until they do. The Decree further contains the following provisions for keeping watch of the process of conversion of certificates of interest into stock of the New Coal Company and, if it is unduly retarded, bringing the matter to an end by directing a forced sale (Record, pp. 294, 295) :

“g. The amount of certificates of interest surrendered for exchange shall be reported monthly by the Trustee or Trustees to the Attorney General of the United States, and at any time upon the request of the Attorney General of the United States the Trustee or Trustees shall furnish him with any additional information which he may require relating to the carrying out of this decree.

“h. If, at any time after July 1, 1924, any of such certificates of interest shall remain outstanding, the Court, in its discretion, after a hearing, upon such notice to holders of certificates of interest as it may direct, may order the shares of the new corporation, represented by said certificates, to be sold and the proceeds distributed to the registered owners of such certificates.”

The provisions with respect to the disposition of the stock of the Reading Coal Company fully conform to the precedent established in the Union Pacific-Southern Pacific case. In that case this Court decided that the combination of the Union Pacific Railroad Company and the Southern Pacific Company, through the ownership by Union Pacific of 46% of the capital stock of Southern Pacific, violated the Anti-Trust Act, in view of the fact that the lines of railroad of these two companies were normally competing. *United States v. Union Pacific Railroad Company*, 226 U. S. 61. Thereafter, this Court was asked by the Attorney General and counsel for the Union Pacific Railroad Company

"to instruct the United States District Court for the District of Utah, by a provision incorporated in the mandate of this Court when issued or otherwise, whether or not a sale of the Southern Pacific Company shares held by said appellees, to the shareholders of the appellee Union Pacific Railroad Company, substantially in proportion to their respective holdings, or a distribution thereof by dividend to the Union Pacific stockholders entitled to such dividend, would, in the opinion of this Court, constitute a disposition of said shares in compliance with the opinion herein filed on December 2, 1912."

This Court decided that such disposition would

"perpetuate the domination and control of the Union Pacific over the Southern Pacific Company because of the power given to the Union Pacific Company's stockholders to choose the directors of the Southern Pacific Company." *United States v. Union Pacific Railroad Company*, 226 U. S. 470, 475."

In conformity with that opinion the District Court for the District of Utah by its decree ordered (see "Decrees and Judgments in Federal Anti-Trust Cases," compiled by Roger Shale under direction of G. Carroll Todd, p. 217, Government Printing Office, 1918) :

"Section 4. The shares of the defendant Southern Pacific Company held by the defendant Oregon Short Line Railroad Company remaining after the sale to the Pennsylvania Railroad Company of 382,924 shares thereof as hereinabove provided, to wit, 883,576 shares, or the entire holdings if such sale to the Pennsylvania Railroad Company shall not be consummated within 30 days from the date hereof, shall be transferred forthwith to the Trustee and registered in its name on the books of the Southern Pacific Company, and certificates therefor delivered to the Trustee.

* * * * *

"Section 5. Prior to November 1, 1913, the defendants Union Pacific Railroad Company and

Oregon Short Line Railroad Company shall offer to all stockholders of the former, common and preferred (registered as such on a date to be designated in the offer and not more than 40 days from its date) or to their assignees, the right to subscribe for certificates of interest representing the said Southern Pacific Company shares transferred to the Trustee as provided hereunder, substantially in the proportion of their respective holdings, with such allowance in fixing the distribution ratio as the above-named defendants may deem necessary for possible conversions of convertible bonds of the said Union Pacific Railroad Company. The offering shall include all accumulated dividends appertaining to said shares, and shall be at such price and upon such other terms as the defendants Union Pacific Railroad Company and Oregon Short Line Railroad Company shall determine, except as specifically herein prescribed or as otherwise directed by the court by a subsequent order or decree.

* * * * *

"Section 6. The Trustee shall execute and issue certificates of interest representing the shares transferred to it hereunder and shall deliver them at its office in the City of New York to the subscribers therefor under section 5 hereof, upon payment in full of the subscription price and compliance in all respects with the terms prescribed by the offering, or by any subscription receipt issued under section 7 hereof, to be performed by the subscribers to entitle them to receive such certificates of interest; and in like manner shall deliver such certificates of interest upon full payment therefor to any other purchasers to whom the defendants Union Pacific Railroad Company and Oregon Short Line Railroad Company shall be authorized by the court to sell the same. All such certificates shall be registered by the Trustee in the names of the purchasers. They shall be substantially in the form hereto annexed marked "Form A."

* * * * *

"Section 11. At any time upon demand, at its office in the city of New York, upon surrender of

any outstanding certificate of interest by the registered owner thereof or his assignee, the Trustee shall deliver to him stock certificates for the number of shares of the defendant Southern Pacific Company (of the par value of \$100 each) represented by the surrendered certificate of interest, which stock certificates shall be issued by the said Southern Pacific Company and registered on its books in the name of the new holder, upon condition, however, that the applicant for such conversion or exchange shall file with the Trustee a duly executed affidavit in one of the forms hereto annexed."

The affidavit attached to the decree in the Union Pacific-Southern Pacific case (which is substantially in accordance with the affidavit required by the decree of the District Court in this case) is as follows:

"State of _____, County of _____ :

being duly sworn deposes and says:

That deponent is the *bona fide* owner in his own proper right of a certificate or certificates of interest numbered _____ for _____ shares registered in the name of _____, issued by the Central Trust Company, of New York, as Trustee, under a decree entered on the day of June, 1913, by the District Court of the United States for the District of Utah, in the suit of the United States of America against Union Pacific Railroad Company and others, and makes this affidavit for the purpose of procuring the issue of shares of the capital stock of the Southern Pacific Company held by the said Trustee, in exchange for said certificate (or certificates) of interest. That deponent does not own in his (or her) own right any shares of the capital stock of the Union Pacific Railroad Company, a corporation of the State of Utah, whether registered in his (or her) own name on the books of said Union Pacific Railroad Company or registered in the names of others for deponent's use and benefit. That deponent, in making this application, is not acting for or on behalf of any

stockholder of the Union Pacific Railroad Company, or in concert, agreement, or understanding with any other person, firm, or corporation for the control of the Southern Pacific Company in the interest of the Union Pacific Railroad Company, but in his own behalf in good faith.

Sworn to before me this day of
191 ."

In two respects the provisions of the decree for the disposition of the stock of the Reading Coal Company go further than the decree in the Union Pacific case:

(1) The intervention of the New Coal Company between the Reading Coal Company and the ultimate beneficial ownership to be established pursuant to the decree, furnishes an additional safeguard. The names of the officers and directors of the New Coal Company to be elected and appointed in the first instance must be submitted to the District Court for its approval. (Record, p. 291). The decree provides:

"a. The names of the officers and directors of the new corporation [the New Coal Company] to be elected and appointed in the first instance shall be submitted to the Court for its approval, and no officer or director of the new corporation shall be an officer or director of the Reading Company."

The New Coal Company is required by the Court to enter its appearance in this cause and thereby submit itself to the jurisdiction of the District Court for all the purposes of this cause. (Record, p. 291.) The decree provides:

"b. The Reading Company shall not sell, assign or transfer its right, title and interest in the stock of the [Reading] Coal Company to the new corporation [the New Coal Company] unless and until the new corporation shall enter its appearance herein by counsel and thereby submit itself to the jurisdiction of this Court for all purposes of this cause; and it shall thereupon become a party defend-

ant in this cause and subject to the provisions of this decree. * * *

The New Coal Company and its officers and directors, are thereupon enjoined and restrained from exercising the voting power on the stock of the Reading Coal Company so as to form such a combination between the Reading Coal Company and the Reading Company (*i. e.* the Holding Company or the New Railway Company) as has been adjudged unlawful in this cause (Record, p. 295). The decree provides :

"j. Effective upon its becoming a party defendant in this cause, as hereinbefore provided, the new corporation, its officers and directors are hereby enjoined and restrained from exercising the voting power on the stock of the Coal Company so as to form such a combination between the Coal Company and the defendant Reading Company as has been adjudged unlawful in this cause."

Thus the District Court has created a situation which very effectively perpetuates the dissolution decree.

The District Court will retain control of the New Coal Company so as to prevent its being used to thwart the decree. The District Court said in its opinion (Record, pp. 283, 284) :

"* * * In the creation of such a corporation by this Court's order, we follow a general course pursued in the case of *United States v. Du Pont, et al.*, 188 F. R., 127, and the wisdom of so doing will be seen by an examination of the opinion lately filed in that case, where the purpose of such procedure is fully explained. By the creation of this new corporation by the directions of this Court and by its retention of jurisdiction to enforce this decree as therein provided, the Court can, if such contingency should arise, by its control of this newly formed corporation, control all of its stockholders and prevent such stock from ever being used to thwart the decree made in pursuance of the plan."

The opinion lately filed, above referred to, in *United States v. E. I. du Pont de Nemours & Company*, is reported in 273 Fed. Rep., 869.

(2) The decree of the District Court goes further than did the decree in the Union Pacific-Southern Pacific case also in that the Reading decree provides (Record, p. 295) that, during the period allowed for the conversion of certificates of interest into stock of the New Coal Company, no present stockholder of the Holding Company shall be a purchaser of stock of the New Coal Company if still a stockholder of the Holding Company. This provision relates to the beneficial ownership and not to holdings as broker, pledgee, trustee, agent or otherwise in a representative capacity. The decree provides:

"i. During the period allowed for the conversion of the certificates of interest into stock of the new corporation [the New Coal Company], no present stockholder of the Reading Company shall be a purchaser of stock of the new corporation if still a stockholder of the Reading Company; and the Attorney General of the United States shall have access to the stock transfer books of the Reading Company and the new corporation for the purpose of enabling him to enforce compliance by such stockholders with this provision of this decree; but nothing herein contained shall extend to holdings as broker, pledgee, trustee, agent or otherwise in a representative capacity."

It was intended by this provision to prevent the evasion of the decree by the sale of certificates of interest in the market and the purchase of stock of the New Coal Company in the market by stockholders of the Holding Company.

Finally the decree provides (Record, p. 295):

"k. The Reading Company, and all persons acting for or in its interest, are hereby perpetually enjoined from acquiring, receiving, holding, voting,

or in any manner acting as the owner of any of the shares of the capital stock of the new corporation; and the new corporation, and all persons acting for or in its interest, are hereby perpetually enjoined from acquiring, receiving, holding, voting, or in any manner acting as the owner of any of the shares of the capital stock of the Reading Company."

III

The fact that the General Mortgage Bonds remain outstanding and the General Mortgage remains a lien on the property and stock of the Reading Coal Company as well as on the property of the New Railway Company is not inconsistent with the entire independence of the Reading Coal Company from the Holding Company and the New Railway Company.

The General Mortgage constitutes, and under the Modified Plan and decree will continue, a lien, among other things, upon the stock and property of the Reading Coal Company. Section 4 of the Original Plan contemplated the voluntary release of the coal property from the lien of the General Mortgage and the discharge of the Reading Coal Company from liability on the General Mortgage Bonds, provided such release and discharge could be secured by payment by the Holding Company to the bondholders of a premium not exceeding ten per cent. upon the par value of the outstanding General Mortgage Bonds. Such release and payment were to be made from time to time as the acquiescence of the several bondholders was given (Record, p. 41). The acceptance of this offer was to be optional with the General Mortgage bondholders.

Section 5 of the Original Plan contemplated the release of the stock of the Reading Coal Company from the lien of the General Mortgage on such terms as the Court should fix.

These features of the Original Plan were objected to by the Trustee under the General Mortgage and by certain bondholders and stockholders of the Holding Company.

The General Mortgage Bonds mature January 1, 1997, that is, in about 75 years. They are not subject to redemption before maturity. The General Mortgage is printed in the Old Record, page 1653. Article Six, providing for the release of mortgaged property, does not permit the release of the property of the Reading Coal Company as a whole, nor the release of the stock of the Reading Coal Company.

Though the General Mortgage was executed and some of the bonds secured by it were issued as a part of the process of forming the combination held to be unlawful, others of the bonds (approximately one-half) secured by the General Mortgage were subsequently issued, in the ordinary course of business, for refunding, betterments, etc. Neither the bondholders nor the Trustee under the General Mortgage were parties to this cause until after the decision of this Court had been rendered. That decision required "the disposition of the shares of stock and bonds and other property of the various companies *held* by the Reading Company"; but it did not require that bonds *issued* by the Reading Company should be disturbed.

When therefore the Trustee under the General Mortgage, and bondholders and stockholders made objection to the release of the stock of the Reading Coal Company from the lien of the General Mortgage and to the proposal for the release of the property (Record, p. 152), modifications of the Plan were filed. (Record, p. 210) by which the objectionable features were eliminated. The ten per cent. optional premium to General Mortgage bondholders and the provision looking towards the release of the coal property from the lien of the General Mortgage before maturity were abandoned, and it was provided that the certificates for stock of the Reading Coal Company should be permitted

remain with the Trustee under the General Mortgage, though the Holding Company's right, title and interest therein and all right to receive dividends and vote thereon were to be transferred to the New Coal Company.

In the foregoing paragraphs are indicated some of the legal and practical difficulties in the way of providing for the sale of the Reading Coal Company stock owned by the Holding Company free from the lien of the General Mortgage. Enough has been said to show that very real difficulties did exist. It did not seem necessary to determine whether or not those difficulties were insuperable, for it became evident that the opinion and judgment of this Court could be fully satisfied without disturbing the lien of the General Mortgage.

It is believed that the release of the Reading Coal Company stock from the General Mortgage is neither necessary nor desirable and that the results which would be attained by such release are equally attained under the provisions of the Modified Plan and of the decree. The stock simply stands today as a muniment of title. It stands for the right to own, control and enjoy the income of the Reading Coal Company. These rights all pass under the Modified Plan and the decree to the New Coal Company.

Under the decree the Holding Company will surrender all its interest in the stock of the Reading Coal Company, including the present right to vote and receive dividends thereon, and will covenant to release said stock and the coal property from the lien of the General Mortgage at or before its maturity. The New Railway Company will be bound to save the Reading Coal Company and its property and the New Coal Company harmless therefrom (Record, pp. 274, 275). The result will be that one principal debtor will take the place of the present joint principal obligation and the Reading Coal Company and its stock and property will stand as surety for the payment of the bonds (Record, p. 188).

The value of the property subject to the General Mortgage (excluding the property and stock of the Reading Coal Company) will be so greatly in excess of the amount of outstanding General Mortgage Bonds that there is no reasonable doubt that the indemnity of the New Railway Company is ample protection for the property of the Reading Coal Company and the equity of the New Coal Company in the stock of the Reading Coal Company. Moreover, the earnings of the railroad property in the past have greatly exceeded the amount required for interest on the General Mortgage Bonds.

As of December 31, 1920, the book value of the fixed properties, which will, on the consummation of the Plan, be directly subject to the General Mortgage (excluding the stock and property of the Reading Coal Company), after deducting all liens thereon prior to the General Mortgage, was approximately \$200,000,000, (Record, p. 200) or more than twice the \$93,269,000 principal amount of the General Mortgage Bonds outstanding (Record, p. 157). In addition, there are pledged under the General Mortgage stocks and bonds of subsidiary railroad and terminal companies auxiliary to the lines of railroad owned by the Reading Railway Company (excluding the stock of the Reading Coal Company and the stock and bonds of the Reading Railway Company) having a par value in excess of \$38,000,000 (Old Record, pp. 1666-1668).

The interest on the \$93,269,000 General Mortgage Bonds outstanding December 31, 1920 (Record, p. 157) amounts to \$3,730,760 per annum. An analysis of the statements on page 259 of the Record and of the dividend record of the Holding Company shows that the combined net earnings of the Holding Company and the Reading Railway Company, during the ten-year period 1911-1920 (excluding payments made by the Reading Coal Company to the Holding Company in the years 1911-1913, and excluding amounts in excess of \$30,000,000 earned by the Reading Railway Company during that period and expended for additions and betterments to its property

after payment of taxes and all fixed charges other than interest on the General Mortgage Bonds, were more than three times the interest on the General Mortgage Bonds. In the figures referred to are included dividends paid on the Holding Company's stock in the Central Railroad Company in excess of interest on the Collateral Trust Bonds secured by that stock. It is impossible to forecast the financial outcome of the disposition of the stock of the Central Railroad Company; but, as against the possible net loss of revenue on that account, the earnings of the New Railway Company will be increased by \$1,000,000 per annum which it will receive as interest on \$25,000,000 of bonds of the Reading Coal Company.

In view of this substantial excess in the value of the railroad properties over the outstanding General Mortgage Bonds, and of the proved ability of the railroad properties to earn several times the General Mortgage interest requirements, it cannot be questioned that the New Coal Company and the coal properties will be placed beyond the reach of any influence or coercion by the New Railway Company, and that a default under the General Mortgage is a contingency too remote to require consideration. This remote contingency has, however, been fully guarded against by the following provision of the Final Decree (Record, p. 298) :

"6. If by reason of default on the General Mortgage bonds Central Union Trust Company of New York, the Trustee under the General Mortgage, shall exercise the right to vote the stock of the Coal Company, it shall so exercise that right as not to bring about unity of management between the Coal Company and the Reading Company; and in the event that said Trustee at any time is obliged to sell the stock or properties of the Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests."

IV

The issue to the Holding Company of the \$25,000,000 mortgage bonds of the Reading Coal Company is not inconsistent with the entire independence of these Companies.

The \$25,000,000 bonds which under the decree are to be issued by the Reading Coal Company to the New Railway Company will not enable the New Railway Company to exercise any control over the Reading Coal Company or the coal properties.

The new mortgage of the Reading Coal Company under which these bonds are to be issued will not be a lien on the stock of the Reading Coal Company, though it will be a lien upon its property.

A mortgage debt does not enable the creditor to exercise control over the debtor when the amount of the debt is safely within the debtor's ability to pay.

The balance sheet of the Reading Coal Company as of December 31, 1920 (Record, p. 198), shows a capital account of \$74,471,690.53, and funded debt (after wiping out the claim of the Holding Company, as provided by the Plan) of only \$870,000. Thus the fixed assets of the Reading Coal Company are practically three times the amount of the bonds to be delivered to the New Railway Company. The average annual net income of the Reading Coal Company for the five years 1916-1920, both inclusive, was \$4,319,908.95 (Record, p. 199), or more than four times the interest on these bonds. Under these circumstances, the ownership of these bonds can in no way give the New Railway Company any present or prospective influence or control over the Reading Coal Company.

The \$25,000,000 mortgage bonds will be a free asset in the treasury of the New Railway Company and will presumably be disposed of for cash as soon as conditions permit them to be sold upon reasonable terms.

V

What the basis is upon which the amount and character of the payments to be made by the Reading Coal Company and by the New Coal Company to the Holding Company was arrived at and what the reasons were for adopting it.

The amount and character of these payments was arrived at in an effort (1) to settle the involved financial relations between the Holding Company and the Reading Coal Company; (2) to insure to the New Railway Company and the New Coal Company, each, a sound financial structure and adequate cash working capital; (3) to limit as far as possible the requirements for new cash under difficult market conditions; and (4) to make the inevitable loss to the stockholders of the Holding Company as small as possible.

The General Mortgage Bonds, the net amount of which outstanding on December 31, 1920, was \$93,269,000, are the joint obligation of the Holding Company and the Reading Coal Company. The Holding Company has a claim against the Reading Coal Company, the nominal amount of which as carried on the books of those companies as of December 31, 1920 (Record, p. 162), was \$69,357,017.99. The Holding Company owns, subject to the lien of the General Mortgage, all the capital stock of the Reading Coal Company, the par amount of which is \$8,000,000. These three items, the \$69,357,017.99 claim, the joint obligation on \$93,269,000 General Mortgage Bonds, and the \$8,000,000 stockholding, were the ties to be severed.

The Reading Coal Company has only \$870,000 funded debt, in addition to the General Mortgage Bonds (Record, p. 198); and its current assets are several times greater than its current liabilities. Subject only to the rights of the General Mortgage bondholders, which, as we have seen, are protected under the decree, the Holding

Company is accordingly in a position, in making the settlement with, and disposition of the stock of, the Reading Coal Company, as required by the decision of this Court, to make such arrangements as seem most advantageous to the stockholders of the Holding Company; the capital and surplus of the Holding Company itself being protected under the Plan (Record, pp. 171, 200).

Under the Plan the General Mortgage bonds are assumed by the Holding Company which will agree to save the Reading Coal Company and the New Coal Company harmless therefrom; the \$69,357,017.99 claim is cancelled and general releases are exchanged between the Holding Company and the Reading Coal Company; and the Holding Company's equity in the stock of the Reading Coal Company, together with the present right to receive dividends and to vote thereon, is transferred to the New Coal Company.

The joint General Mortgage Bonds have 75 years to run and are not subject to redemption before maturity. It was obvious, however, that the character of these bonds as joint bonds must be destroyed in practical effect. This could be done by assumption of the bonds as the sole obligation of one of the companies.

The whole amount of the General Mortgage Bonds is carried on the books of the Holding Company as a liability of the Holding Company (Record, p. 200). No part of the General Mortgage Bonds is carried on the books of the Reading Coal Company as a liability of the Reading Coal Company (Record, p. 198). The General Mortgage contains no indication of the liability of the companies *inter sese* except that it provides in sections 4 and 6 of Article Four (Old Record, pp. 1712, 1715) that, in case of sale in enforcement of the Mortgage, the property mortgaged thereunder shall be sold in two separate lots, of which the first lot to be sold shall be the property granted by or on behalf of the Holding Company, and the second lot to be sold shall be the property granted by or on behalf of the Reading Coal Company.

The income and assets of the New Railway Company and the Reading Coal Company have been discussed in Points III and IV. The income of the New Railway Company based on the earnings of the period from 1911 to 1920 was shown to be more than three times the interest on the General Mortgage bonds. The average income of the Reading Coal Company for the period from 1916 to 1920 did not greatly exceed that interest. Obviously as between the New Railway Company and the Reading Coal Company it was clear which must assume the General Mortgage. One or the other must take the whole load. The New Railway Company was the one which had a demonstrated capacity to carry it.

On the other hand, it was not wise that this burden should be assumed by the New Railway Company without any contribution by the Reading Coal Company. It seemed that for a proper distribution of the load the Reading Coal Company should contribute \$10,000,000 in cash and cash assets and \$25,000,000 in four per cent. mortgage bonds.

Had it been practicable to call the General Mortgage bonds for redemption, doubtless that would have been done and new bonds issued in about the same proportions as between the New Railway Company and the Reading Coal Company, but there were two objections, each controlling: (1) the bonds are not subject to redemption at any price; and (2) if they had been, to redeem \$93,269,000 4% bonds, having 75 years to run, would, in the market conditions prevailing, have been financial madness.

Similarly had it been practicable and wise an effort might have been made to sell the \$25,000,000 bonds of the Reading Coal Company immediately for cash, or, eliminating the bonds altogether, to sell the stock for a larger sum in cash. That would, however, under prevailing market conditions, have meant a grave sacrifice of the stockholders' property to provide cash for which neither Company had any immediate need.

The \$10,000,000 in cash and cash assets the Reading Coal Company had to spare as appears from its tentative general balance sheet as of December 31, 1920 (Record, p. 198). The Reading Coal Company had \$6,506,955.26 in Liberty Bonds and \$8,245,174.27 in cash and in addition had a very large excess of current assets over current liabilities. It was thought that the Reading Coal Company could well spare \$10,000,000 in Liberty Bonds and cash.

On the other hand, an examination of the comparative working assets and liabilities as of December 31, 1920, of the Holding Company, the Reading Railway Company and the New Railway Company (Record, p. 202) shows that the Holding Company had a deficit in working assets of \$6,812,659.70, that the Reading Railway Company had a surplus in working assets of only \$2,626,176.24 and that the New Railway Company, after giving effect to the Original Plan, would have had a surplus in working assets of only \$3,843,350.51. It would seem that the resulting surplus of working assets over liabilities of \$3,843,350.51 was neither inadequate nor excessive.*

*Under the Modified Plan the cash position of the New Railway Company will be better by \$9,400,000. The Original Plan contemplated (Record, pp. 162, 163) that the New Railway Company should receive in cash and cash assets.

(a) From the Reading Coal Company.....	\$10,000,000
(b) From the Holding Company's stockholders.....	5,600,000

Total	\$15,600,000
but should have to pay out to General Mortgage bondholders	
not to exceed	9,400,000

Net cash receipts	\$6,200,000
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All these items were taken into account in determining for working assets and liabilities of the New Railway Company as of December 31, 1920 (Record, p. 202). At a later date, that is, in May, 1921, the Plan was modified so as to eliminate the \$9,400,000 payment to General Mortgage bondholders (Record, p. 210), but no one suggested then the reduction of the payments to be made by the Reading Coal Company or by the New Coal Company. Indeed, it was evident then that to reduce further or to eliminate the payments to be made to the Holding Company by the Reading Coal Company, the New Coal Company or the Holding Company's stockholders, would have served only to inflame and exaggerate the controversy between the preferred and common stockholders by increasing the value of the subject-matter of the controversy.

Thus the fact is that the payments to be made to the New Railway Company by the Reading Coal Company and by the New Coal Company were, as stated in the answer of the Holding Company (Record, p. 163), when the Original Plan was filed, adequate for the requirements of the Holding Company.

Without imposing new and unnecessary burdens to provide the cost of new and unnecessary financing, the Modified Plan and decree (a) redistribute existing burdens between the New Railway Company and the Reading Coal Company approximately in proportion to their relative ability to bear them; (b) apportion to the New Railway Company property the earnings and income of which, during the past ten years and after allowing for adjustments incident to the Plan and the Decree, have been several times the interest on the General Mortgage bonds, leaving an ample margin for dividends; (c) apportion to the Reading Coal Company properties the average annual earnings of which for five years past have been more than four times the interest charges on the \$25,000,000 mortgage, leaving a handsome margin for additions, betterments, improvements and for dividends; (d) provide both companies ample working capital; (e) give the stockholders of the Holding Company an opportunity to liquidate gradually their holdings in one company or the other, and thus limit their losses.

The control of the Reading Coal Company will pass immediately from the Holding Company to the nominees of the District Court. The stockholders of the Holding Company will, however, have a reasonable opportunity to sell either the stock of the Holding Company, or the certificates of interest in the stock of the New Coal Company. Thus it is expected the stockholders of the Holding Company will be enabled to protect themselves from some part at least of the loss which would be inevitable if the stock of the Reading Coal Company or the New Coal Company

were thrown directly upon the market. So great a property as that of the Reading Coal Company cannot, under the peculiar general conditions now existing, and under the peculiar special conditions affecting the Reading coal property, be advantageously sold at this time or in bulk (Record, p. 163). The Plan and Decree give the stockholders the benefit of the hope that they may realize more for the coal property than the Holding Company itself could realize for it in the event of a direct sale (Record, p. 163).

VI

Compliance with the decree will not confer on any one class of stockholders of the Holding Company any benefit to the prejudice of the rights of any other class of stockholders.

In support of this point reference is made to the brief for Reading Company, on the original argument of these appeals, filed in this Court January 9, 1922.

VII

The merger of the Reading Railway Company by the Holding Company, the acceptance of the Constitution of Pennsylvania and the surrender of powers inappropriate for a railroad corporation establish a condition in harmony with the decision of this Court.

As to the combination between the Holding Company and the Reading Railway Company, the decree also is in conformity with the opinion of this Court in 253 U. S. 26.

It had been believed by the Holding Company that the relation between the Holding Company and the Reading

Railway Company, in and of itself, contained no vice, but this Court denied, without opinion, the motion of the Holding Company for permission to retain either the Reading Railway Company or the Reading Coal Company. (*United States v. Reading Company*, 253 U. S. 478.) In the absence of any indication from this Court, it was assumed that the objection of this Court was to the control of the Reading Railway Company by the Holding Company acting under a special charter, free from regulation by State and Federal authorities having jurisdiction over railroads, and free conceivably to embark upon a new series of combinations in contravention of the law as determined by this Court. At any rate, it was necessary to get rid of this relation, and in doing so to get rid of the Holding Company as such. It was *functus officio*.

It was very evident, both from a study of the opinion of this Court and from obvious considerations of public interest, that merely to terminate the relation between the Holding Company and the Reading Railway Company by the sale of the stock, or stock and bonds, of the Reading Railway Company owned by the Holding Company, and nothing more, though it might have satisfied the letter, would have in large measure defeated the purpose of the decision of this Court. To do so would have left the Holding Company possessed of railroad rolling stock and floating equipment, of real estate needed for railroad purposes, and of securities giving control over railroads and terminals constituting part of the Reading system. It was obvious that the decree, in addition to terminating the relation between the Holding Company and the Reading Railway Company, after the Holding Company had been stripped of its interest in the Reading Coal Company and the Central Railroad Company and the Wilkes-Barre Coal Company, should also *bring together* into one company the remaining properties of the Holding Company and the Reading Railway Company. The relation between the Holding Company and the Reading Rail-

way Company must be terminated not by separation, but by combination. Otherwise that very position of dependence for rolling stock and floating equipment and for traffic from subsidiary lines, which was clearly in the mind of this Court, in its account of the effect of the reorganization of 1896, as a fundamental vice of the situation then created, would be perpetuated and become irremediable. For the Holding Company to sell the stock of the Reading Railway Company and nothing more would have been to perpetuate the situation which this Court frowned upon, because it would have perpetuated the mutual inter-dependence between the Holding Company and the Reading Railway Company. The Reading Railway Company would have owned the railroad system without adequate rolling or floating equipment or tributary lines. The Holding Company would have owned rolling stock and floating equipment and tributary lines in large part useless to it except in connection with the lines of railroad of the Reading Railway system.

The shares of stock and bonds of the Reading Railway Company held by the Holding Company will by operation of law be extinguished by the merger of the two companies. The other assets of the Holding Company and of the Reading Railway Company include besides lines of railroad, rolling stock, real estate, etc., the entire capital stock of Reading Iron Company and stocks and bonds of and claims against various railroad companies and terminal companies carried on the books at \$71,057,130.01. (Record, p. 200.) The names of these companies and the amounts of the securities transferred to the Holding Company at the time of the reorganization in 1896 are set forth in the Old Record at pages 1298-1300. The assets of the Holding Company and of the Reading Railway Company not otherwise disposed of, by force of the Decree or for some other reason, will automatically become the property of the New Railway Company.

It would have been possible to effect the termination of the relation, and the combination of the assets, thus clearly indicated as necessary in order to comply with the spirit as well as the letter of the opinion of this Court in 253 U. S. 26, by way of consolidation, merger or sale from one company to the other. In fact, a merger of the Reading Railway Company by the Holding Company is contemplated. Whatever method was adopted, it was obvious that the resulting company must be a Pennsylvania railroad corporation having the powers and subject to the restrictions and regulations governing such a corporation. This the decree effects.

The Holding Company had outstanding capital stock of the par amount of \$140,000,000, of which \$70,000,000 is preferred stock and \$70,000,000 common stock (Record p. 157). It had outstanding \$93,269,000 of General Mortgage bonds as to which the Reading Coal Company was co-obligor with it (Record p. 157) and other bonds and obligations to the amount on December 31, 1919, of \$38,279,315.28 (Record p. 115).

It was the Holding Company's securities which were outstanding in the hands of the public. Any Plan which had undertaken to disturb the outstanding stock of the Holding Company, the outstanding General Mortgage bonds and the other bonds of or guaranteed by the Holding Company would have involved a vast underwriting expense and, in all probability, grave loss to security holders of some or all classes. The Plan of having the Holding Company merge the Reading Railway Company and then reform and transform itself into an operating railroad company pure and simple seemed best adapted to avoid disturbance of outstanding securities.

Section 2 of Article Ten of the General Mortgage (Old Record, p. 1734) permits any lawful consolidation or merger of the mortgagor companies, i. e., the Holding Com-

pany and the Reading Coal Company or either of them, with each other *or with any other corporation*, or any conveyance and transfer subject to the continuing lien of the General Mortgage of all the mortgaged and pledged premises of the Holding Company or of the Reading Coal Company, or of the property of the Reading Railway Company as an entirety to some corporation lawfully entitled to acquire it, provided that such consolidation, merger or sale shall not impair the lien and security of the General Mortgage or any of the rights or powers of the Trustee or of the bondholders thereunder, and that the payment of the principal and interest of the bonds shall be assumed by every corporation formed by such consolidation or merger or purchasing as aforesaid. This provision expressly permits the merger feature of the Modified Plan and of the decree of the District Court.

The brief submitted on behalf of the Insurance Companies upon the first argument of these appeals erroneously states (p. 3) that under the Plan the Holding Company is to retain its charter. This Court has called attention to the fact that the Reading Company is a holding company having a special "omnibus" charter entitling it to engage in, or control, almost any business other than that of a bank of issue (Record, pp. 8, 20). It is not a common carrier and is not subject to regulation by Federal or State authorities having jurisdiction over railroads (Record, p. 157). It is of the very essence of the Plan, of the Government's consent and approval of it, and of the Decree of the Court below, that the Reading Railway Company shall be merged into the Holding Company and that the latter shall cease to be a holding company, surrender its extraordinary powers, and become a railroad company in all respects subject to the regulation of State and Federal authorities as a common carrier (Record, pp. 43, 277).

Under its charter the Holding Company is empowered

“* * * to merge or consolidate, or unite with the said company the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon; * * *” (Record, p. 193).

The Pennsylvania Act of 1856 provides for the surrender of charter powers, if the stockholders consent and a court of common pleas approve. Said Act is as follows:

“Section 1. *Be it enacted by the Senate and House of Representatives of the Commonwealth of Pennsylvania in General Assembly met, and it is hereby enacted by the authority of the same, That it shall be lawful for any court of common pleas of the proper county to hear the petition of any corporation under the seal thereof, by and with the consent of a majority of a meeting of the corporators, duly convened, praying for permission to surrender any power contained in its charter, or for the dissolution of such corporation; and if such court shall be satisfied that the prayer of such petition may be granted, without prejudice to the public welfare, or the interests of the corporators, the court may enter a decree in accordance with the prayer of the petition, whereupon such power shall cease or such corporation be dissolved: Provided, That the surrender of any such power shall not in any wise remove any limitation or restriction in such charter; and that the accounts of the managers, directors or trustees of any dissolved company shall be settled in such court, and be approved thereby; and dividends of the effects shall be made among any corporators entitled thereto, as in the case of the accounts of assignees and trustees: Provided further, That no property devoted to religious, literary, or charitable uses shall be diverted from the objects for which they were given or granted: Provided, That the decree of said court shall not go into effect until a certified copy thereof be filed and recorded in the office of the secretary of the commonwealth.*” (Laws of Pennsylvania, 1856, p. 293, No. 308.)

The Pennsylvania Act of 1874 provides for acceptance of the Constitution of the State of Pennsylvania if the stockholders consent. Said Act is as follows:

"Section 1. *Be it enacted, etc.*, That it shall be the duty of the board of directors of any railroad, canal or other transportation company in existence on the first day of January, one thousand eight hundred and seventy-four, desiring to accept of the provisions of the seventeenth article of the constitution of the state, adopted on the sixteenth day of December, one thousand eight hundred and seventy-three, to file in the office of the secretary of the commonwealth a certificate in writing, signed by the president and secretary, and attested by the corporate seal of the company, stating that at a regular or special meeting of said board of directors a resolution, in pursuance of the consent of the stockholders, was adopted, accepting of all the provisions of said article; and all the powers and privileges, and the limitations and restrictions mentioned therein, shall be deemed and taken for all purposes to apply to said corporation; the said certificate shall be recorded in the office of the secretary of the commonwealth, in a suitable book to be by him kept for that purpose.

"Section 2. No such certificate shall be made by the officers aforesaid, without the consent of the stockholders of the corporation, to be obtained by an election to be held in the same manner as prescribed by law for increasing the capital stock of a corporation." (By the consent of a majority of the stockholders.) (Laws of Pennsylvania 1874, p. 275, No. 157.)

Evidently these matters must be laid before the stockholders for their approval, as the decree provides (Record, p. 297).

After such action the New Railway Company formed by the merger will have no powers except those granted to railroad companies incorporated under the general laws of Pennsylvania.

Under the law of Pennsylvania whenever there is a union of two or more corporations, the resulting corporation is a new corporation, distinct from any of the original corporations. This is true whether the union be called a merger or a consolidation; the two terms are interchangeable. *Lauman v. The Lebanon Valley Railroad Company*, 30 Pa. St. 42; *Dalmas v. Philipsburg & Susquehanna Valley Railroad Company*, 254 Pa. St. 9; *Pennsylvania Utilities Company v. Public Service Commission*, 69 Pa. Sup. Ct. 612.

The case of *Lauman v. The Lebanon Valley Railroad Company*, 30 Pa. St. 42, was a bill to enjoin The Lebanon Valley Railroad Company from merging with the Philadelphia and Reading Railroad Company, under a special Act of Assembly which gave them power to merge. The Court said, on page 45:

"This is called a merger of the Lebanon corporation into the other; but such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved."

In the case of *Dalmas v. Philipsburg & Susquehanna Railroad Company*, 254 Pa. St. 9, the Court discussed merger under various acts, including the Merger Act of 1865. An interpretation of the word merger as used in these acts passed both before and after the Charter of the Reading Company is an aid in the construction of the legislative intention in the use of the words "merge" and "consolidate" in that Charter. The lower court (its opinion was adopted by the upper court, which affirmed the decision without an opinion), said, on page 15:

"When two or more corporations merge, the presumption is that all of the property of each constituent company is transferred to and becomes the property of the new company, and that from the time of the completion of said merger the constituent companies cease to exist so far as the terms of

the act of assembly, under which said merger is effected, preserve their existence; and in order to overcome this presumption there must be a saving clause in the merger proceedings. No such saving clause appears in this bill."

There is no such saving clause in the Charter of the Holding Company (Record p. 189).

In the case of *Pennsylvania Utilities Company v. Public Service Commission*, 69 Pa. Sup. Ct. 612, the Court cites *Lauman v. The Lebanon Valley Railroad Company* with approval in discussing the Merger Act of 1909, Pennsylvania Laws, p. 408, No. 229, which provides:

"Section 1. Be it enacted, &c., That it shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made."

The Court said, page 618:

"It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new

company you must be referred to what existed in the old companies does not affect this result * * *".

The Holding Company will thus be deprived, by the decision of this Court, and the execution of the Plan, of its properties, its corporate powers, its corporate existence even. Though the proceedings take the form of a merger by the Holding Company of the Reading Railway Company, a new corporation will result from these proceedings, and that not a holding company but a railroad company.

Having regard then to the purposes for which it was formed, or reformed, in 1896, to its status and its corporate history as a holding company organized and operated (in the words of Mr. Justice CLARKE—Record, p. 9) "for producing, purchasing, and selling coal and for transporting it to market" through the railroad and coal companies as its agents or instrumentalities, "the mining and transportation departments of its business"; having regard also to the utter disintegration of this business which the decree directs and the Plan effects, and to the termination of the corporate powers and the very corporate existence of the condemned holding company; it is apparent that the decree directs and the Plan effects a very complete and practical dissolution of the Holding Company.

VIII.

The Modified Plan and the decree properly avoid unnecessary disturbance of outstanding securities.

A principal advantage of the particular Plan adopted was that it involved the least possible disturbance of existing securities. This is a consideration at all times of prac-

"* * * In view of the considerations we have stated we leave the matter to the court below to work out a compliance with the law without unnecessary injury to the public or the rights of private property."

IX

As to the combination between the Holding Company and the Central Railroad Company, the decree also is in conformity with the opinion of this Court.

This Court held the control by the Holding Company of the Central Railroad Company to be unlawful, and referred to the acquisition by the Holding Company of the stock of the Central Railroad Company, as follows (233 U. S. 57):

"Again, when in 1901 a rivalry, imaginary or real, arose for the control of the Central Railroad Company, the Holding Company, regardless of the law, did not hesitate to purchase control of that great competing anthracite coal carrying system, with its extensive coal owning and mining subsidiary. This acquisition placed the Holding Company in a position of dominating control not only over two great competing interstate railroad carriers but also over two great competing coal companies, engaged extensively in mining and selling anthracite coal, which must be transported to interstate markets over the controlled interstate lines of railway.

* * * * *

"For flagrant violation of the first and second sections of the Anti-Trust Act, the relations between the Reading Company, the Reading Railway Company and the Reading Coal Company and between these companies and the Central Railroad Company of New Jersey must be so dissolved as to give to each of them a position in all respects indepen-

dent and free from stock or other control of either of the other corporations."

The opinion of this court further held (253 U. S. 64) that as to the Holding Company and the Central Railroad Company the decree of the District Court must be reversed and the cause remanded with directions to enter a decree dissolving the combination of the Holding Company, and the Central Railroad Company, with such provision for the disposition of the shares of stock of that company held by the Holding Company, "as may be necessary to establish the entire independence of that company."

In conformity with the opinion of this court the decree of the District Court provides (Record, pp. 296-297) :

"4. The provisions of Section 7 of the Modified Plan shall be consummated as follows:

"a. The Reading Company shall transfer to a Trustee or Trustees to be appointed by this Court (hereinafter called the Jersey Central Trustee), subject to the lien of the Jersey Central Collateral Trust Mortgage dated April 1, 1901 (hereinafter called the Jersey Central Collateral Trust) from Reading Company to The Pennsylvania Company for Insurances on Lives and Granting Annuities, Trustee (hereinafter called the Pennsylvania Company), its right, title and interest in the stock of the Jersey Central.

"b. The Jersey Central Trustee shall hold said right, title and interest in said shares of stock transferred to it as hereinabove provided, subject to the order of this Court. The final disposition of said stock shall be deferred in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, until ordered by this Court. The Court may in its discretion upon its own initiative or upon motion of the United States or the Reading Company without waiting such action by the Interstate Commerce Commission, enter an order for the sale of such

stock, if and when it shall appear that the facts require it, or the situation makes it possible.

"c. The Jersey Central Trustee shall be entitled and it shall be its duty, to vote or cause to be voted all said shares of the Jersey Central unless otherwise hereafter directed by the Court. The Reading Company is hereby enjoined and restrained from voting upon any such shares of stock of the Jersey Central. The Reading Company shall from time to time direct the Pennsylvania Company, pursuant to the provisions of said Jersey Central Collateral Trust, to execute and deliver to the Jersey Central Trustee or its nominees suitable powers of attorney or proxies to vote upon such shares of stock.

"d. Pending the entry of an order by this Court directing the final disposition of the Jersey Central stock, the Jersey Central Trustee is hereby enjoined and restrained from exercising the voting power on the Jersey Central stock in such a way as to cause any dependence or intercorporate relations between the defendants Reading Company and the Jersey Central, and in particular from voting so that any officer or director of the Reading Company shall be elected an officer or director of the Jersey Central.

"e. Pending the final disposition of the Jersey Central stock the Reading Company shall be entitled to receive all cash dividends on the stock of the Jersey Central. All dividends payable otherwise than in cash which shall be declared by the Jersey Central shall be received and held by the Jersey Central Trustee upon the same terms and conditions as the right, title and interest of Reading Company in the shares of stock in the Jersey Central originally transferred until finally disposed of as may be directed by order of this Court."

The reasons of the District Court for adopting this method of securing the complete independence of the Central Railroad Company from the Holding Company are set forth in the opinion of that court filed May 21, 1921 (Record, pp. 284-286) :

"The paragraph of the original Reading Plan numbered eight, which is paragraph numbered seven of the plan as modified in accordance with the agreement between Reading Company and the Attorney General of the United States as of May 12, 1921, contains the only provision in the plan proposed to carry out the mandate of the Supreme Court of the United States which is not agreed to in all of its details by the Reading Company and the Attorney General, and as to this provision of the plan the disagreement relates only to a matter of time.

"The section referred to concerns the disposition by the Reading Company of the stock of the Central Railroad of New Jersey owned by the former, and as to this disposition Reading Company and the Attorney General agree, that the stock shall be transferred to one or more trustees, individual or corporate, to be held and voted under the terms of the trust until sold to a purchaser other than the parties defendant in this cause.

"Reading Company contends that the spirit and the letter of section five of the Interstate Commerce Act, as amended by the Transportation Act of 1920, justifies its prayer that the value of this stock of the Central Railroad Company of New Jersey shall not be subjected to possible sacrifice by a sale until the Interstate Commerce Commission shall adopt a consolidation plan which will designate the several railroads of the East with which the Central Railroad Company of New Jersey may be consolidated, so that assurance may be given to a railroad company purchaser of this stock that the holding of it by such purchaser will not be objectionable.

"The Attorney General has contended that the stock should be placed in the hands of a trustee or trustees under a decree of this Court which shall direct Reading Company to proceed with all due diligence to offer the same for sale within a definite period, and if at the expiration of such period a purchaser has not been found by Reading Company, then upon the application of the Attorney General the Court may decree a sale of this stock at public auction or in such manner as the Court shall then provide.

"The Court is of opinion that because of the provisions of the Transportation Act of 1920 there is presently no prospective purchaser of the Jersey Central stock at a fair price, and so long as the control of the voting power of this stock is taken from Reading Company and lodged with a trustee or trustees, acting under the supervision of this Court, there is full compliance with the mandate of the Supreme Court, which requires that there shall be established entire independence between these two companies, and we are also of opinion there is no good reason why the decree of this Court shall now subject the stock to the possible sacrifice of a forced sale to the detriment not only of the Reading Company but also to the almost equal number of other shareholders of the Jersey Central who are not parties to this record, who have no right to be heard and yet who may be very seriously affected by a decree of this Court ordering at the present time, a forced sale of this majority stock.

"The final decree to be entered herein, therefore, will direct the transfer of the stock of the Central Railroad Company of New Jersey, owned by Reading Company, to such trustee or trustees, individual or corporate, as the Court may name, and shall contain the terms of the trust, which in substance shall provide that the stock shall be voted by the trustee or trustees so that at all times there shall be entire independence of directors and management between Reading Company, as it shall be hereafter merged with Reading Railway Company, and the Central Railroad Company of New Jersey; and that pending a sale of the stock all dividends received by the trustee or trustees upon the same shall be paid to Reading Company or as it shall direct, and that the actual sale of the stock of the Central Railroad Company of New Jersey shall be deferred in view of the possible grouping of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, subject, however, to a provision in the decree that on motion of the United States or other party, or upon the Court's own initiative, that without awaiting such action by the Interstate

Commerce Commission, an order may be entered hereafter, for the sale of such stock, if and when it shall appear to the Court that the facts require it, or the situation makes it possible."

Section 5 of the Interstate Commerce Act, as amended by the Transportation Act, 1920, provides, in part, as follows:

"4. The Commission shall as soon as practicable prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. In the division of such railways into such systems under such plan, competition shall be preserved as fully as possible and wherever practicable the existing routes and channels of trade and commerce shall be maintained. Subject to the foregoing requirements, the several systems shall be so arranged that the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties.

"6. It shall be lawful for two or more carriers by railroad, subject to this Act, to consolidate their properties or any part thereof, into one corporation for the ownership, management and operation of the properties theretofore in separate ownership, management and operation, under the following conditions:

"(a) The proposed consolidation must be in harmony with and in furtherance of the complete plan of consolidation mentioned in paragraph 5 and must be approved by the Commission; * * * *

"8. The carriers affected by any order made under the foregoing provisions of this section and any corporation organized to effect a consolidation approved and authorized in such order shall be, and they are hereby, relieved from the operation of the 'anti-trust laws', as designated in Section I, of the Act entitled 'An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,' approved October 15, 1914, and of all other restraints or prohibitions by law, State or Federal, in so far as may be necessary to enable them to do anything authorized or required by any order made under and pursuant to the foregoing provisions of this section."

The decree of the District Court fully complies with the opinion of this Court in that it insures the immediate independence of the Central Railroad Company from the Holding Company by vesting in trustees appointed by the District Court in its decree of June 11, 1921 (Record, p. 313), the right, title and interest of the Holding Company in the stock of the Central Railroad Company, carrying with it the power to vote the controlling shares of the stock of the latter until such time as by further order of the Court the shares of stock might be finally disposed of.

By the decree the trustees so appointed are enjoined and restrained from exercising the voting power on the stock of the Central Railroad Company in such a way as to cause any dependence or intercorporate relations between the Holding Company and the Central Railroad Company, and in particular from voting so that any officer or director of the Holding Company shall be elected an officer or director of the Central Railroad Company.

The final disposition of the stock of the Central Railroad Company was deferred until ordered by the Court in view of the possible grouping of railroads by the Interstate Commerce Commission under the Transportation Act of 1920.

Otherwise the lawful exercise of powers by the Interstate Commerce Commission might have been irreparably interfered with by a final decree of the District Court in this cause, subsequently ascertained to be in conflict with the orders of the Commission to be entered under the Transportation Act of 1920. This provision of the decree was to accord with the action taken by this Court in the case of *United States v. Terminal Railroad Association of St. Louis*, 224 U. S. 383. In that case this Court remanded the cause to the District Court with instructions to enter a decree embodying a plan for the reorganization of the defendant companies and indicated specifically certain provisions to be embodied in this plan for reorganization, expressly providing, however (page 412), that

"the decree should also contain a provision that nothing therein shall be taken to affect in any wise or at any time the power of the Interstate Commerce Commission over the rates to be charged, * * * etc., or any other power conferred by law upon such Commission."

The Court below was cautious, however, to preserve its control over the situation by further order in addition to its control of the voting power of the stock through its trustees, and qualified its postponement of the sale by the latter part of paragraph (b) of section 4 of the decree, in which it provided (Record, p. 296):

"* * * The Court may in its discretion upon its own initiative or upon motion of the United States or the Reading Company without waiting such action by the Interstate Commerce Commission, enter an order for the sale of such stock, if and when it shall appear that the facts require it, or the situation makes it possible."

X

The disposition of the stock of the Wilkes-Barre Coal Company by the Central Railroad Company establishes the entire independence of the Wilkes-Barre Coal Company from the Central Railroad Company and from the other corporate defendants.

As to the combination between the Central Railroad Company and the Wilkes-Barre Coal Company, the decree also is in conformity with the opinion of this Court. The opinion of this Court affirmed the original judgment of the District Court with reference to the sale by Central Railroad Company of the stock of the Wilkes-Barre Coal Company owned by it, and directed that

“ * * * such disposition shall be made by the decree of the stocks and bonds of the Lehigh & Wilkes-Barre Coal Company, held by the Central Railroad Company of New Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all of these now combined companies may be conducted in harmony with the law.”

The decree of the District Court provides (Record, p. 298), in paragraph 8 thereof, as follows:

“8. The Central Railroad Company of New Jersey shall dispose of all the capital stock of The Lehigh & Wilkes-Barre Coal Company now owned by it to persons or corporations who are not its own stockholders or stockholders in either the Reading Company, the Railway Company or the Coal Company, and who previous to or at the time of purchase shall qualify as purchasers by a duly executed affidavit in one of the forms hereto annexed. * * *

CONCLUSION

The Decree of the District Court should be affirmed.

Respectfully submitted,

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IN THE
Supreme Court of the United States.

OCTOBER TERM, 1921.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCK-
NER and JOHN H. MASON, as a Com-
mittee, etc.,

Appellants,

AGAINST

READING COMPANY, *et al.*,
Appellees.

REPLY BRIEF FOR APPELLANTS.

In the main brief of these appellants it was said, in reference to the distribution of the interest of Reading Company in the Coal Company, that

"the appellee Reading Company has undertaken to show that this distribution is either a sale or is a disposition of a capital asset, or, finally, is a partial liquidation upon a partial dissolution of the company" (pp. 47, 48).

and further that

"the appellee Reading Company, in defense of the Plan made mandatory by the decree, has argued

indiscriminately that it is a sale, that it is a distribution of a capital asset, and that it is a partial liquidation on partial dissolution, without taking any definite position as to which of the three it claims this distribution to be" (p. 54).

In its brief in this Court, however, the appellee Reading Company has practically abandoned all the positions it took in the District Court, and has now taken the position in this Court that the distribution of its interest in the Coal Company and its union with the Railway Company, as provided in the Plan, constitute a complete liquidation on final dissolution.

This change in positions presents a new question, and this reply brief is, therefore, submitted primarily to explain this change in positions and to discuss the new question now presented.

The Positions of Reading Company in the District Court.

The positions of Reading Company in the proceedings upon the mandate of this Court, after these appellants and certain of the appellees had petitioned for leave to intervene, are shown by its Answer to Intervening Petitions and Cross Petition (Transcript, pp. 153-202) and its Memorandum in support thereof, parts of which are printed as appendices hereto.

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a sale, Reading Company stated that

"The coal stock is to be *sold*" (italics theirs).
 * * * "The sale is compulsory and will result in a loss, not a profit" (Answer—Transcript, p. 162).

and further, that the

"consideration is less than it is hoped will prove to be the intrinsic value of the coal property. It is,

however, a substantial, not a nominal, consideration and is in the judgment of the board of directors of the Reading Company adequate for the requirements of the Reading Company" (Answer—Transcript, p. 163).

Following this is a detailed discussion of the reasons urged in justification of this disposition as a sale (Transcript, pp. 163-164), concluding with the suggestion that

"If the intervening holders of common stock object to having certificates of interest in the coal property sold to the preferred and common stockholders ratably, the remedy of the common stockholders is to offer a higher price, with the right to the preferred stockholders to bid against them; or to ask the court to require that the certificates of interest be sold at public sale to the highest bidder, with the right to the stockholders, preferred and common, singly or in groups, and to the general public, to bid" (Transcript, p. 164).

In the Memorandum in support of the Answer this disposition is described in the heading of Point 1 in the following unmistakable language:

"The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature" (App. A, p. 33).

and this disposition is claimed to be in all respects similar to the disposition by the Union Pacific Railroad Company of its interest in the Southern Pacific Company (App. A, p. 36), in which, as has been shown in the main brief

of these appellants (pp. 29-34), there was an actual sale at approximately the market price.*

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a disposition of a capital asset, Reading Company stated that

"The thing to be sold, the stock of the Coal Company, is a capital asset, and not in any sense earnings or profits of the Reading Company" (Answer-Transcript, p. 164).

Following this is a detailed discussion of the reasons urged in opposition to the contention of these appellants that, if a disposition of a capital asset is, in fact, involved, the capital stock of Reading Company should be reduced accordingly.

And following this is a detailed discussion of the reasons urged for the view that the accumulated surplus of the Reading Company and of the Railway Company have been so "ploughed back into the property" as to be unavailable for dividends and as to have become a part of its *corpus* (Transcript, pp. 171-173), thus taking on, as these appellants understand the argument, the nature and characteristics of capital assets.

*The Plan *itself* (Paragraph 5, Transcript, pp. 275-6) specifically refers to the Union Pacific-Southern Pacific case as the precedent in accordance with which the so-called sale is to be carried out and the Petition of Adrian Iselin, *et al.* (Transcript, pp. 137-138) maintains that the so-called sale is in conformity with that precedent. Accordingly, these appellants showed in their main brief (pp. 29-34) that the alleged similarity between the disposition by the Union Pacific Railroad Company of its interest in the Southern Pacific Company and the so-called sale provided in the Plan will not bear analysis. How completely the Union Pacific-Southern Pacific case has been abandoned as a precedent is shown by the fact that there is no mention of it in the brief on appeal of Adrian Iselin, *et al.*, and that the brief on appeal of Reading Company undertakes to show that it was relied upon by Reading Company only in support of its affirmative answer to a "question (not in issue on these appeals) submitted by the District Court among other questions for argument" and "that case has no bearing one way or another upon the question at issue upon these appeals, for the Southern Pacific stock was sold at or about its market value" (p. 39), thus conceding the essential distinction that these appellants insisted upon.

In undertaking to show that the disposition of its interest in the Coal Company under the Plan is a partial liquidation upon a partial dissolution of the Company, the Answer of Reading Company goes into an elaborate analysis of the terms of the charter and stock certificates, which analysis refers to such interest as one that is not being detached from the capital "by any voluntary act of the Company but only by a compulsion that makes such detachment a distribution of assets in partial liquidation of the corporation" (Transcript, p. 174).

From this analysis the conclusion is drawn

"that, in the event—deemed so unlikely—of some uncurrent distribution not in the nature of a dividend, not declared as a dividend and compulsorily made in spite of a determination not to declare a dividend, the assets so parted with, being assets which, in the case of a liquidation or dissolution of the company, would by plain and explicit provision go to the stockholders, preferred and common, share and share alike, should go precisely the same way in case of a partial liquidation even though no dissolution occurred" (Transcript, p. 180).

And finally it is asserted that the Plan

"is designed and intended to carry into effect the mandate of the Supreme Court of the United States requiring at least a partial liquidation of the assets of the Reading Company to the extent that it requires it to dispose of its interest in the stock of the Coal Company" (Transcript, p. 180).

The Answer having characterized the disposition of the interest of Reading Company in the Coal Company under the Plan as a partial liquidation even though no dissolution occurs, and having maintained that the rules of law governing complete liquidation on final dissolution should apply, the Memorandum, therefore, cites an English and a New Jersey case—and no Pennsylvania

cases—upon the respective rights of preferred and common stockholders upon complete liquidation on final dissolution (Appendix B, pp. 38-40).

The Opinion of the District Court.

The opinion of the District Court (Transcript, pp. 278-286) is entirely in harmony with the positions taken by the Reading Company in the proceedings before it.

The opinion explains that the Coal Company stock

“is to be taken by the Court and disposed of absolutely by it, by *sale* through the agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it” (Transcript, p. 281—italics ours).

The opinion then declares the disposition of the interest of Reading Company under the plan to be

“a taking by the law of an asset of that company, a *stock asset*, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself” (Transcript, p. 281—italics ours).

The opinion goes on to point out that

“Indeed it is now disposed of in substantially the same way *as the law would dispose of the property of that Company were it being dissolved* * * *” (Transcript, p. 281—italics ours).

And, finally, the opinion approves the Plan for reasons which it summarizes in the following language:

“Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal

right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. We are therefore of opinion that the plan which embodies these equitable principles should be approved and that the claim of the common shareholders to take all of this stock to the exclusion of the preferred stockholders should be denied" (Transcript, p. 282).

The Position of Reading Company in This Court.

In its brief on appeal Reading Company practically abandons its position that the disposition of its interest in the Coal Company under the Plan is a sale.

It is true that in one part of its brief (pp. 50-51) there is a formal summary of certain of the statements in its Answer, but no effort is made to assert, as was asserted in the Answer, that the consideration is "a substantial, not a nominal, consideration" (Transcript, p. 163). In fact, the brief asserts that

"So great a property as that of the Coal Company cannot, under the peculiar general conditions now existing, and under the peculiar special conditions affecting the Reading coal property, be advantageously sold at this time or in bulk" (p. 50).

The sale theory is now passed over with the explanation that the

"price which the Reading Company will receive for the coal property" was "fixed with regard to the requirements of the Reading Company" (p. 50).

Viewed from the standpoint of a sale, the Plan is stated to be

"not only advantageous from the point of view of prompt compliance with the Mandate of this Court, in that it immediately divests the Reading Company of all ownership and control of the Coal Company,

but is also advantageous to the stockholders of the Reading Company, in that it gives them the benefit of the hope that they may realize more for the property than the Reading Company itself could realize for it in the event of a direct sale" (pp. 50-51).

But the abandonment of the sale theory goes beyond that. The objections of these appellants to the sale theory are conceded in the following language:

"Probably the actual value of the certificates of interest in the stock of the new corporation lies somewhere between \$42,357,017.99, the book value to the Reading Company of the interest in the Coal Company sold by it to the new corporation, and \$5,600,000, the purchase price to be paid by subscribers to the new corporation for certificates of interest. That the right to subscribe for the certificates of interest is a valuable right is not denied; just how valuable it is, is undetermined" (p. 10).

These objections, however, are dismissed in the following language:

"The question of actual value is not, however, of importance on these appeals, for concededly the right to subscribe for the certificates of interest is a valuable right and the legal principles governing the disposition of that right must be the same whether its actual value be greater or less" (p. 11).

This can only mean that the Reading Company now considers it immaterial whether the disposition of its interest in the Coal Company under the Plan is a sale or not.

The Reading Company also practically abandons its position that the disposition of its interest in the Coal Company under the Plan is the disposition of a capital asset. All that its brief on appeal contains in support of this position is the following:

"The stock of the Coal Company is a capital asset, and not in any sense earnings or profits of the Read-

ing Company. It was acquired by the Reading Company in 1896, as part of the consideration for the issue of the present outstanding stocks and bonds (Record, p. 160), and the present book value to the Reading Company of its investment in the coal property is not materially greater than it was at the time of such acquisition (Record, p. 162)" (p. 51).

The substance of this is taken from the opinion of the District Court (Transcript, p. 281), but no argument is offered in support of it.

The Reading Company also abandons its position that the disposition of its interest in the Coal Company under the Plan is a partial liquidation upon a partial dissolution of the Company.

The expression "partial liquidation", which appears so frequently in the Answer and Cross Petition of the Reading Company (Transcript, pp. 153-202), is nowhere to be found in its brief on appeal. In lieu of that position, the brief of Reading Company now takes the position (p. 21) that

"the decree directs and the Plan effects the disposition of all the assets of the Reading Company, the termination of its corporate life, of its business life as a holding company and its regeneration as an operating railroad company, subject to the control of the State and Federal authorities as a common carrier."

and the last section of its brief is devoted to a support of this new position (Sec. IX, pp. 63-75).

The theory upon which Reading Company now contends that the decree directs and the Plan effects a final dissolution and complete liquidation of Reading Company may be briefly stated as follows:

The decree directs and the Plan effects a liquidation of the interest of Reading Company in the Coal Company by means of the so-called sale.

This, upon the assumption that may be implied from the Reading Company's brief, leaves as its only remaining assets to be liquidated its interest in the Railway Company. It is then argued that the union of Reading Company and the Railway Company directed by the decree and to be effected by the Plan brings about a dissolution of the Reading Company, as well as of the Railway Company, and brings into existence a new corporation. The resulting surrender by the stockholders of Reading Company of their interest therein and their acquisition, in lieu thereof, of their interest as stockholders in the new corporation are stated to constitute a liquidation of the interest of Reading Company in the Railway Company, and, therefore, to effectuate a complete liquidation of its assets.

Nothing is said, however, of what is to become of certain important assets of Reading Company that have no connection with its interest in the Coal Company or its interest in the Railway Company, such, for example, as its interest in Reading Iron Company.* Presumably, this interest is to pass to the alleged new corporation, and, in view of the fact that its ownership by the alleged new corporation will be foreign to the railroad business, to which the activities of the alleged new corporation are, it is stated, to be exclusively confined, it may be assumed that the alleged new corporation will at some early date dispose of its interest in Reading Iron Company. Upon such disposition the holders of common stock of Reading Company, in view of its attitude in this appeal, may expect to be met with a plan which

* The interest of Reading Company in Reading Iron Company is represented by \$1,000,000, being all, of the capital stock thereof, which is pledged under the General Mortgage (Transcript, p. 232). This capital stock, however, is practically a muniment of title of an interest of far greater value, for it is shown in the petition of Frances T. Ingraham *et al.* (Transcript, pp. 120-130) that a crude estimate made in 1920 by one of the leading financial authorities placed a value thereon of \$22,791,500 (Transcript, p. 123).

will provide for the distribution of this interest to the preferred and common stockholders, share and share alike—not, perhaps, upon the theory of a dissolution and liquidation, but upon some theory designed to show that the distribution is something other than a dividend.

The Questions Now Discussed in the Brief of Reading Company.

In view of this change in positions by the Reading Company, the questions now discussed in its brief on appeal may be stated to be:

1. Whether or not the decree directs and the Plan effects a complete liquidation of the assets, and a final corporate dissolution, of Reading Company.
2. Whether or not the preferred stockholders are entitled to any distribution out of the surplus of Reading Company.

The first question was not before the District Court, as has been shown above.

The second question was before the District Court, but was not decided by it for reasons that were stated in its opinion as follows:

“under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings” (Transcript, p. 282).

Both of these questions are dealt with extensively in the brief on appeal of Reading Company and are discussed in their order below.

ARGUMENT.**I.**

The decree does not direct and the Plan does not effect a complete liquidation of the assets or a final corporate dissolution of Reading Company.

The Plan provides:

"6. The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage. The name of the Reading Company, after merger, will not be changed. The Reading Company will accept the Pennsylvania Constitution of 1874, and it will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated" (Transcript, pp. 276, 277).

This states the practical effect of the consummation of the Plan. There is nothing in the Plan, or in the Answer to Intervening Petitions and Cross Petition of the Reading Company, or in its Memorandum in support thereof, that even suggests that the effect of the Plan is to bring about a final dissolution of Reading Company and a complete liquidation of its assets as a result thereof.

In fact, the foregoing quotation from the Plan negatives any idea that there is to be a dissolution of Reading Com-

pany; for it states, not that it is the corporate existence of Reading Company which is to be terminated, but merely its relation as a specially chartered holding company to the Philadelphia & Reading Railway Company. Furthermore, throughout its lengthy Answer to Intervening Petitions and Cross Petition (Transcript, pp. 153-186), the Reading Company, both as it now exists, and as it would exist after its proposed union with the Railway Company, is referred to in identically the same way. An examination of this Answer and Cross Petition makes it clear beyond question that it was written without any thought that Reading Company after its proposed union with the Railway Company would be a corporation distinct from Reading Company as it now exists.

The Reading Company in its brief on appeal now contends that

“Under the law of Pennsylvania whenever there is a union of two or more corporations, the resulting corporation is a new corporation, distinct from any of the original corporations. This is true whether the union be called a merger or a consolidation; the two terms are interchangeable” (pp. 71, 72).

As authority for this proposition, the following cases are cited:

Lauman v. The Lebanon Valley R. R. Co., 30 Pa. St. 42;
Dalmas v. Philipsburg & Susquehanna Valley R. R. Co., 254 Pa. St. 9; and
Pennsylvania Utilities Co. v. Public Service Comm., 69 Pa. Sup. Ct. 612.

The *Lauman* case, *supra*, was examined by this Court in *Central Railroad and Banking Co. v. State of Georgia*,

92 U. S. 665, and in its decision this Court said, at page 671:

"Laumann v. R. R. Co., 30 Pa. 46, was a bill by a stockholder for an injunction against consolidation; and all that was decided was, that his interest must be protected before consolidation could take place."

In the *Dalmas* case the Supreme Court of Pennsylvania affirmed a decree on the opinion of the Court below and wrote no opinion of its own. The opinion of the Court below dealt with acts of the Legislature of the State of Pennsylvania other than the Act of 1909 (Laws of Pennsylvania, 1909, p. 408, No. 229), pursuant to which the proposed union of Reading Company and the Railway Company is to take place, and cannot, therefore, be considered authority for the general proposition above quoted, or authority for anything beyond the meaning of the acts it discusses as applied to the facts in the case.

The *Pennsylvania Utilities Co.* case, *supra*, deals with nothing but the effect upon the status of corporations which unite under it of the Act of 1909, *supra*, pursuant to which the proposed union of the Reading Company and the Railway Company is to take place. The decision is confined strictly to the meaning of that act, and cannot be deemed authority for any such general proposition as the one above quoted. This case is further discussed in its proper relation.

In its brief on appeal, however, Reading Company relies on the following language from the opinion of the lower Court upon which the Supreme Court of Pennsylvania in the *Dalmas* case, *supra*, affirmed the decree:

"When two or more corporations merge, the presumption is that all of the property of each constituent company is transferred to and becomes the property of the new company, and that from the time of the completion of said merger the constituent companies cease to exist so far as the terms of the act

of assembly, under which said merger is effected, preserve their existence; and in order to overcome this presumption there must be a saving clause in the merger proceedings. No such saving clause appears in this bill" (pp. 72, 73),

and points out that there is no such saving clause in the charter of the Reading Company (p. 73).

Following this, it quotes Section 1 of the Act of 1909, *supra*, pursuant to which the proposed union of Reading Company and the Railway Company is to take place, and, as construing the meaning of said section, quotes from an opinion of one of the Superior Courts of Pennsylvania, in the *Pennsylvania Utilities Company* case, *supra*, as follows:

"It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: * * *" (pp. 73, 74).

It seems that the meaning of this section has never been passed upon by the Supreme Court of Pennsylvania. This section authorizes a corporation

"to merge its corporate rights, franchises, powers, and privileges with *and into* those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then

by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation *into which* such merger shall be made:" (Reading Company Brief, p. 73—italics ours).

The powers granted in this section extend primarily to the corporations that are to be merged *into* other corporations, and not to the corporations *into which* the merger is to be made. As to the latter, this section clearly indicates that their corporate existence is to continue. The statement in the opinion of the Superior Court that "Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation" is clearly contrary to the plain meaning of said Section 1 taken alone.

This act contains no grant of corporate powers but merely continues the corporate powers of the constituent corporations. Section 1 is the essential part of the act, but the following sections, which deal with the mechanics of the union of the corporations, employ the term "new corporation" in a descriptive sense. This would not seem to satisfy the following rule as laid down by this Court.

In *Central Railroad and Banking Company v. State of Georgia*, *supra*, this Court said, at page 670:

"It may be that the consolidation of two Corporations, or amalgamations, as it is called in England, if full and complete, may work a dissolution of them both and its effect may be the creation of a new Corporation. Whether such be the effect or not must depend upon the statute under which the consolidation takes place, and on the intention therein manifested. If, in the statute, there be no words of grant of corporate powers, it is difficult to see how a new Corporation is created. If it is, it must be by implication; and it is an unbending rule that a grant of

corporate existence is never implied. In the construction of a statute, every presumption is against it."

Reading Company in its brief on appeal reaches the conclusion that

"The Reading Company will thus be deprived, by the decision of this Court, and the execution of the Plan, of its properties, its corporate powers, its corporate existence even. Though the proceedings take the form of a merger by the Holding Company of the Railway Company, a new corporation will result from these proceedings, and that not a holding company but a railroad company" (p. 74).

It is submitted that the proposed union of Reading Company and the Railway Company not only takes "the form of a merger by the Holding Company of the Railway Company", but actually is a merger by the Holding Company of the Railway Company, and that the "very complete and practical dissolution of the Reading Company" that its brief on appeal (p. 74) refers to has no foundation in fact or substance, and has not even a technical existence except upon the authority of the opinion of one of the lower Courts of the State of Pennsylvania in the *Pennsylvania Utilities Company* case, *supra*.

It is upon this showing that this Court is asked to conclude that the decree directs and the Plan effects a final dissolution of Reading Company and a complete liquidation of its assets upon such dissolution.

Even though the claim that a dissolution of the Reading Company will arise upon the proposed union of Reading Company and the Railway Company may be supported by some language in the act pursuant to which the union is to take place indicating the intent of the Legislature that a new corporation should come into existence, such dissolution would not be, in substance, a dissolution at all, but a mere legal fiction.

This is a suit in equity, and this Court will look through the forms to the realities of the situation. Furthermore, this Court would not make its determination upon the basis of an abstract legal fiction in a case such as this even if such a fiction in support of Reading Company's claim of dissolution were in existence, where upon the basis of the concrete realities of the situation a contrary determination would be reached.

The realities of the situation are:

1. Reading Company will continue as a going concern, without any dissolution or termination of its corporate existence;

2. In doing this, Reading Company will surrender only such of its powers as it may not retain pursuant to the mandate of this Court, and pursuant to its acceptance of the provisions of the Pennsylvania Constitution of 1874, but will retain unchanged all of its other corporate powers;

3. In doing this, Reading Company will surrender only its interest in the Coal Company, but will retain unchanged all of its other assets; there will be no distribution of the assets to its stockholders as in case of liquidation on dissolution;

4. The Reading Company's corporate name will remain unchanged;

5. No change whatever in the contract between Reading Company and its stockholders and among its stockholders is to be made; and, in fact,

6. The stockholders of Reading Company are to retain, without change therein, the very stock certificates that they now hold.

If the stock of Reading Company were owned by one group of stockholders, and the stock of the Railway Company were owned by another and distinct group of stockholders, there might, of course, be some substance to the claim of a complete liquidation on final dissolution, and there might be some reality to what could be, as has been explained, under present circumstances, only an abstract legal fiction. But, in view of the realities that have just been set forth, it is submitted that this Court will not be influenced by the abstract deductions which, in contemplation of law, may be made from the union of the Reading Company and another corporation, to wit, the Railway Company, which has no stockholder except the Reading Company, and all of whose stock Reading Company has owned since the year 1896.

II.

The preferred stockholders of Reading Company are not entitled to any distribution out of the surplus of Reading Company.

The position of these appellants, as set forth in their main brief, may be summarized as follows:

1. That the distribution of the interest of Reading Company in the Coal Company under the Plan effectuates a distribution, in part at least, of or from the surplus net profits of Reading Company;
2. That the holders of the preferred stock of Reading Company are entitled to non-cumulative dividends not exceeding four per cent. per annum, and no more; and
3. That the holders of common stock of Reading Company are absolutely entitled to distributions out

to which the preferred stocks are entitled and that is expressed in the words "not exceeding four per cent. per annum" contained in the preferred stock certificates, and to show that this limitation does not apply to distributions of accumulated net earnings, to distributions of such part of the surplus as may have become a part of "capital assets" of the corporation, and, particularly, to the distribution of the interest of Reading Company in the Coal Company under the Plan, which involves a reduction in the surplus of approximately \$38,000,000.

Nowhere in the brief on appeal of Reading Company is the above quoted limitation directly discussed, even in instances where it may not, on any theory, be properly ignored. Some of these instances are as follows:

On page 82 of the brief of these appellants the cases of

Fidelity Trust Co. v. Lehigh Valley R. Co., 215

Pa. 610; 64 Atl. Rep. 829 (1906);

Sternbergh v. Brock, 225 Pa. 279; 74 Atl. Rep. 166 (1909);

Sterling v. H. F. Watson Co., 241 Pa. 105; 88 Atl. Rep. 297;

Englander v. Osborne, 261 Pa. 366; 104 Atl. Rep. 614 (1918),

are referred to, and it is stated:

"In each of these cases the preferred stock was *cumulative* and contained no limitation to a specified dividend in each and every fiscal year, such as is contained in the Reading Company preferred stock certificates. Consequently, the controversy between the preferred and common stockholders called for the application by the Court of the rule that is peculiar to Pennsylvania and that has been heretofore discussed."

This rule is, in substance, that a preference specified in a preferred stock certificate does not, of itself, involve a limitation, or, in other words, that no limitation can be

implied from the preference. Consequently, the above quoted part of the brief of these appellants is intended to show that the foregoing cases have no bearing upon the issues in this appeal, for the reason that the Reading Company preferred stock certificates contain a specific limitation, and that these appellants have in no instance undertaken to read a limitation into them by implication. Under these circumstances, the existence of the limitation upon the Reading Company preferred stock is of much more importance than the fact that the preferred stocks in the foregoing cases were cumulative. Nevertheless, the brief on appeal of Reading Company (p. 30) merely states:

"The facts relied upon in the brief for the Prosser Committee (p. 82), that the preferred stocks considered in most of these Pennsylvania cases were cumulative, adds rather than detracts from their force as precedents in the Reading case"

and then continues with a discussion of the cumulative feature thereof. The limitation, which is the important consideration, is absolutely ignored.

The heading of Section II of the brief on behalf of Reading Company (p. 22) reads as follows:

"Under the law of Pennsylvania preferred and common stockholders have equal rights except as expressly limited by the terms of the contract between them. No preference or limitation can be implied."

In support of this proposition the brief states:

"The Pennsylvania cases establish beyond dispute the principle that, except as otherwise expressly provided in the charter or stock certificates, preferred and common stockholders have in all respects equal rights and privileges, and that no limitation on these rights is to be implied because of any preference granted" (p. 22).

and then cites the four cases above referred to. Thus, again, the specific limitation in the Reading Company stock certificates is absolutely ignored, and it is made to appear that these appellants are undertaking to read a limitation into those stock certificates by implication.

These appellants point out that the limitation upon the right to dividends to the holders of the preferred stock of Reading Company that they have urged, and have discussed, is the limitation that is contained in the preferred stock certificates themselves in the most explicit language, and they flatly deny that they have ever attempted to read into the preferred stock certificates, by implication or otherwise, any limitation other than the specific limitation that the certificates contain.

The reason why these appellants insist that the foregoing Pennsylvania cases have no bearing upon the issues in this appeal may be explained by the following quotation from the opinion in one of those very cases. In the quotation from the decision in *Fidelity Trust Co. v. Lehigh Valley R. Co.*, *supra*, which appears in the brief on appeal of Reading Company (pp. 24, 25) is the following:

“If the preferred stockholders had been limited, under the terms of the contract, to 10 per cent. per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound” (p. 25).

It is submitted, therefore, that, if the preferred stockholders in that case had been limited as the preferred stockholders of Reading Company are limited—that is to say, if the preferred stock certificates in that case had provided that the preferred stocks are “entitled to non-cumulative dividends at the rate of, but not exceeding, 4% per annum, in each and every fiscal year,” the decision in that case, as plainly indicated by the foregoing

quotation, would have been contrary to what it was. The same is true of the decisions in the other three cases, although the opinions do not so clearly point it out.

The issue that has arisen in respect of the meaning of the terms of the preferred stock certificates does not grow out of any attempt of these appellants to imply any limitation that the preferred stock certificates do not contain, but grows out of an attempt of Reading Company, and the other appellees who are supporting the Plan, to cut down a limitation that the preferred stock certificates do contain, and the real contention of those appellees is succinctly set forth in the following quotation from the brief on appeal of the Reading Company (p. 38) :

"The Reading preferred stock certificate, on the other hand, contains no preference or limitation, expressly or by implication, *except as to participation in current dividends*" (italics ours)

and the same contention is reiterated, in varying language, throughout the greater part of the brief on appeal of Reading Company.

The attempts to support this contention proceed along two lines: first, by way of placing upon the terms of the preferred stock certificates meanings other than the meaning placed thereon by these appellants; and, second, by way of undertaking to distinguish the authorities cited by these appellants in support of the meaning placed on the preferred stock certificates by them.

Proceeding along the line first indicated, the Reading Company opens the argument in its brief on appeal by a general classification of preferred stocks. The brief concedes that the classification has been made "for the purposes of the present discussion" (p. 13), and that the classification sets forth "the general categories into which preferred stocks may properly be classified for purposes

of this discussion" (p. 15). The concession is also made that

"No attempt is made here to describe every possible permutation and combination of the * * * principal factors"

that are set forth in the classification (p. 15).

Obviously, this classification has been prepared on the basis of the terms of the Reading preferred stock certificates, the terms of the preferred stock certificates involved in the authorities cited by the appellants, and the terms of the preferred stock certificates involved in the authorities cited by Reading Company. This classification is, therefore, special, and not general, and, consequently, is not helpful in the discussion of the issues involved in this appeal. In considering it, there will doubtless occur to this Court numerous permutations and combinations of the principal factors it contains that would destroy all of the arguments that have been based upon it; and it is evident that from a selected lot of preferred stock certificates a classification may be worked out to serve the purposes of any one of a number of arguments.

There are also some conclusions set forth in this classification that will not bear analysis. The first of these conclusions is set forth under "Non-Participating Preferred Stocks", and is that "they should not be entitled to share with the holders of common stock in a stock dividend nor to subscribe ratably with the holders of common stock for any new issue of stock since their interest is not affected by an increase in the common stock" (pp. 13, 14).

In the case of *Russell v. American Gas and Electric Co.* (N. Y.), 152 App. Div. 136, a holder of preferred stock, upon an increase of the common stock by means of a distribution of a stock dividend, was denied the right to participate in the common stock dividend, but was

allowed to subscribe for sufficient *preferred stock* to maintain his proportionate interest in the company. Furthermore, his preferred stock was preferred as to assets. This is fully set forth in the main brief of these appellants (pp. 71-73). Preferred stockholders are manifestly affected by an increase in the common stock of a company, and, in the absence of special provisions in the preferred stock certificates, are entitled to maintain their proportionate interest in the company upon general principles of law to which we know no exception.

The second of these conclusions is set forth under the heading of "Participating Preferred Stocks" that are participating as to dividends, and is that

"The holders are entitled to receive a stipulated dividend before any payment is made on the common stock, and after the common stock has received a like dividend, are entitled to participate ratably in any distribution of the remaining surplus earnings" (p. 14).

This conclusion is correct only with respect to the terms of the preferred stock certificates containing no limitation when construed under the rule that is peculiar to the State of Pennsylvania and that is contrary to the weight of authority.

The fact is that preferred stocks are not subject to any classification, however rough or general, for the reason that their terms are so frequently designed to meet the peculiar organization, or reorganization, or financial, problems from which they arise, and the variety of these problems is as extensive as the variety of corporate and financial problems that arise from time to time in the business world.

Departing from this special classification of preferred stocks and coming to the actual terms of the preferred stock certificates the brief on appeal of Reading Company undertakes to show that between what are therein variously characterized as "current dividends" (pp. 15,

16, 20, 22, 38, 48, 55), "dividends from current earnings" (p. 56), "customary dividends" (pp. 19, 21, 22) and "customary distributions from current earnings" (p. 19), on the one hand, and distributions of assets upon final liquidation, on the other hand, there is a twilight zone into which falls the distribution of the interest of Reading Company in the Coal Company; and that the respective rights of preferred and common stockholders, as to distributions of assets that fall into this alleged twilight zone, are to be determined by the rules applying to final liquidations rather than by the rules applying to dividends (pp. 21, 22).

No authority for such a proposition has been cited, and it has been condemned in the authorities cited in the main brief of these appellants, and hereinafter discussed. And no characterization of the word "dividends" as it appears in the preferred stock certificates, such as has been explained above, is justified by anything these certificates contain.

The effect is, of course, to set up a twilight zone to which the limitation as to dividends that is contained in the preferred stock certificates will not apply and to which will apply the general rule that in distribution of assets on final liquidation all classes of stock share equally.

There are two considerations that negative the conclusions that are urged as a result of this effort.

In the first place, the preferred stock certificates refer in three places to dividends at the rate of 4 per cent. per annum as "full dividends", thus clearly disposing of the theory that, short of final liquidation, the preferred stocks can participate in distributions of assets at a rate in excess of 4 per cent. per annum.

In the second place, the preferred stock certificates provide that:

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law."

thus clearly disposing of the theory that the preferred stocks have any absolute right to share equally with the common stock in distribution of assets on final liquidation.

This theory, however, has been practically abandoned in the brief on appeal of Reading Company, for it refers to

"property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them, under the circumstances here obtaining; subject, however, to the right of the company, *under equitable conditions*, to eliminate the preferred stockholders as sharers therein by redeeming the preferred stock at par" (p. 58, italics ours)

and thus practically concedes the claim of these appellants that this right of redemption is, in equity, a limitation upon the general rule that in distribution of assets on final liquidation all classes of stock share equally.

The brief on appeal of Reading Company also undertakes to show that

"The decision of the board of directors"

A. "as to the portion of current earnings up to 4% on the preferred stock which shall go to the preferred stock as dividends, and"

B. "the portion of current earnings, after payment of dividends of 4% to the preferred stock, which shall go to the common stock"

C. "is binding, and

D. "the surplus net profits, of any year, which the board of directors has not determined to declare out for dividends, become part of the general assets of the Company",

E. "which, in the case of an extraordinary distribution under the circumstances here obtaining are—as between preferred and common stockholders—sub-

ject to no preference but are distributable to them share and share alike, without discrimination and without priority or limitation of right" (p. 58 dissected for purposes of discussion).

So much of the foregoing as is comprehended under A, B, C and D is obviously true. All of the assets of a corporation are general assets, in the sense used above, until declared as dividends or until complete liquidation on final dissolution is reached. But E does not follow.

In no case that has been cited has the right of holders of preferred stock to participate in an extraordinary distribution been sustained, except where their shares were *cumulative* or they were entitled to receive the par amount of their shares with accrued dividends thereon upon liquidation. The *Fidelity Trust Company*, *Sternbergh*, *Sterling* and *Englander* cases, *supra*, all come within the exception. These are the Pennsylvania cases upon which the appellees who are supporting the Plan rely. But the Reading Company preferred stock is neither cumulative nor entitled to accrued dividends upon liquidation, and the aforesaid Pennsylvania cases turn on facts that have no resemblance to the facts in this appeal.

Proceeding along the line next indicated, the brief on appeal of Reading Company undertakes to distinguish the authorities cited by these appellants in support of the meaning placed on the preferred stock certificates by them.

In *The Equitable Life Assurance Society v. Union Pacific R. R. Co.*, 212 N. Y. 360, the preferred stock was not preferred as to assets and the words "such Preferred Stock is entitled to no other or further share of the profits" beyond non-cumulative dividends not exceeding 4% per annum were not the determining factor in that case as stated in the brief on appeal of Reading Company (p. 37). The absence of the words quoted would not have

changed the decision. *Stone v. United States Envelope Co.*, 119 Maine, 394, and cases discussed therein.

In *Scott v. The Baltimore and Ohio R. R. Co.*, 93 Md. 475, the same limitation upon the preferred stocks as exists in the Reading Company preferred stock certificates was solely involved. The brief of Reading Company (p. 40) undertakes to distinguish as *dictum* certain parts of the opinion that apply directly to the facts in this appeal, but that alleged *dictum* related to matters that could not have been left out of consideration in the decision in view of the manner in which the issues were presented to the court.

In *Russell v. American Gas and Electric Co.*, 152 App. Div. (N. Y.) 136, and *Niles v. Ludlow Valve Mfg. Co.*, 202 Fed. Rep. 141, the decisions did not turn on the matters referred to in the brief on appeal of Reading Company (pp. 41-43). A preference as to assets does not necessarily give a preferred stockholder any ground to complain of dividends to the common stockholders that do not impair the capital of the corporation. And, as already pointed out, the preferred stock of Reading Company is, in equity, limited as to its participation in assets by the right to redeem the same.

III.

The Plan does not involve a liquidation of the assets of Reading Company.

Under the Plan, the interest of Reading Company in the Coal Company is not to be distributed to the stockholders. The stockholders may not acquire such interest without ceasing to become stockholders. Nor is such interest to be sold and the proceeds distributed to the stockholders. Instead the Plan "makes the stockholders

of the Reading Company a conduit for the transmission of the ownership of the certificates of interests to persons not stockholders in the Reading Company" (Reading Brief, p. 50).

Likewise, under the Plan, the interest of Reading Company in the Railway Company and its other assets are not to be distributed to the stockholders nor are the same to be sold and the proceeds distributed to the stockholders. These assets are to remain undisturbed.

There is to be no such liquidation as to invoke the general rule that all stockholders, preferred and common, share and share alike, participate equally in a final distribution of assets.

Respectfully submitted,

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APPENDIX A.

**MEMORANDUM IN SUPPORT OF ANSWER TO
INTERVENING PETITIONS AND CROSS-PETI-
TION OF DEFENDANT READING COMPANY.**

POINT 1. The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature.

It is the real nature of the transaction and the character of the asset disposed of, not the effect of such disposition on the books of the company, which determine the rights in respect of such disposition.

United States v. Union Pacific Railroad Company, 226 U. S. 61 (1912).

United States Trust Company of New York v. Heye, 181 A. D. (N. Y.) 544; 224 N. Y. 242 (1918).

It seems advisable to set out in some detail the facts in connection with the dissolution of the combination between the Union Pacific Railroad Company and the Southern Pacific Company and the dissolution of the Standard Oil Trust, in connection with which these cases arose.

A. The Union Pacific Case.

(a) The Union Pacific Railroad Company is a corporation of the State of Utah, having both preferred and common stock. Prior to 1908, the Union Pacific owned all the stock of the Oregon Short Line Railroad Company, which in turn owned \$126,650,000, par amount, of the stock of the Southern Pacific Company or about 46% of the outstanding stock. In that year, the Government

brought suit against the Union Pacific, the Oregon Short Line and other defendants, alleging a combination in restraint of trade in violation of the Sherman Act. In 1912 the Supreme Court held that an illegal combination existed, and directed that a plan providing for the disposition of the Southern Pacific stock should be filed with the District Court for the District of Utah. *United States v. Union Pacific Railroad Company, supra.*

Thereafter, various plans were submitted to the District Court and on June 30, 1913, that Court entered a decree approving the sale of \$38,292,400, par value, of the Southern Pacific stock to the Pennsylvania Railroad Company in exchange for \$42,547,200, par value, of the stock of The Baltimore and Ohio Railroad Company, half preferred and half common, and directing that the remaining shares (883,576) should be transferred to Central Trust Company of New York, as Trustee, and that the right to subscribe to certificates of interest representing such shares should be offered to all stockholders of the Union Pacific, common and preferred, *pro rata*, at such price as the Union Pacific should determine.

Pursuant to this decree the Union Pacific offered its stockholders, preferred and common, the right to subscribe ratably to such certificates of interest at \$88 a share, and accrued dividends. At the time of this distribution the Southern Pacific had a surplus of more than \$60,000,000.

(b) Thereafter the Union Pacific declared an extraordinary dividend on its common stock consisting of the following amounts on each share: 1. three dollars in cash; 2. twelve dollars, par value, of preferred stock of the Baltimore and Ohio; 3. twenty-two and a half dollars, par value, of the common stock of the Baltimore and Ohio. The regular dividend on the common stock was at the same time reduced from 10% to 8%, the

reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provide:

"The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company to dividends in each and every fiscal year at such rate not exceeding 4 per cent. per annum, payable out of net profits, as shall be declared by the Board of Directors.

Such dividends are non-cumulative and such Preferred Stock is entitled to no other or further share of the profits."

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, and that, as the preferred stockholders, having received 4% dividends, were entitled to no other or further share of the profits, the dividend was properly declared to the common stockholders.

The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Company, 162 A. D. (N. Y.) 81, 212 N. Y. 360 (1914).

B. The Standard Oil Dissolution.

Prior to 1911 the Standard Oil Company of New Jersey owned the stock of thirty-three subsidiary companies. In that year, on the suit of the Federal Government, a decree was entered in the United States Circuit Court enjoining the continuance of this unlawful combination and permitting the Standard Oil Company to distribute the stocks of its subsidiary companies among its own stockholders. Thereupon the directors resolved that the stocks of subsidiary companies be distributed among the stockholders of the parent company and that the book value of the stocks distributed be charged to "Reserve Profits". The

rights arising out of this distribution were considered by the New York Courts in *United States Trust Company of New York v. Heye, supra*.

This case involved the rights of a life tenant and remainderman under a trust created in 1899. Most of the stocks distributed had originally formed part of the trust estate, and had been exchanged for stock of the Standard Oil Company of New Jersey. The book value of the Standard Oil stock, December 31, 1899, was \$202.32 per share. Before the distribution of December 1, 1911, accumulated earnings had brought the value up to \$566.67, and after the distribution the book value was \$281.72 per share. Therefore, the "Reserved Profits" account against which the distribution was charged consisted largely of earnings accumulated since the creation of the trust. The subsidiaries whose stock was distributed also had large accumulated earnings. The Court said that earnings accumulated since the creation of the trust went to the life tenant, but nevertheless held that the remainderman was entitled to all the stock so distributed except that which had been actually acquired by the Standard Oil Company out of earnings accumulated since the creation of the trust.

C. Application of Foregoing Cases to Point 1.

The difference between the rights of stockholders in case of a sale and their rights in case of a dividend is shown by the two cases arising out of the Union Pacific dissolution proceedings. In the Baltimore and Ohio stock distribution case, *The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Company, supra*, the court held that the Baltimore and Ohio stock distributed (a part of which had been received in exchange for Southern Pacific stock) represented profits of the Union Pacific, and accordingly, when distributed by way of dividend, was properly given to the common stockholders exclusively. In the dissolution proceedings, how-

ever, when the transaction in question was a *sale*, the court directed that the remaining Southern Pacific stock be sold to preferred and common stockholders, *pro rata*.

In the *Heye* case (Standard Oil dissolution) the Board of Directors had resolved that the book value of the stocks distributed should be charged to "Reserve Profits", which consisted in large part of earnings accumulated since the creation of the trust. (See p. 4.) The Court stated the rule that earnings accumulated since the creation of the trust belonged to the life tenants, but nevertheless held that the remainderman was entitled to all the stocks which had originally formed part of the principal of the trust in spite of the fact that the distribution reduced the amount of surplus shown on the books and available for distribution in dividends to the life tenant.

APPENDIX B.

**MEMORANDUM IN SUPPORT OF ANSWER TO
INTERVENING PETITIONS AND CROSS-PETI-
TION OF DEFENDANT READING COMPANY.**

POINT 6. Preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation, unless they are expressly preferred or limited by the terms of the contract between them.

It is well settled that a preference as to dividends does not imply either a preference or a limitation in respect of the right to share equally in assets on liquidation or dissolution.

Birch v. Cropper (In re The Bridgewater Navigation Company, Limited) 14 A. C. 525 (House of Lords 1889) ;

Lloyd v. Pennsylvania Electric Vehicle Company, 75 N. J. Eq. 263, 72 Atl. 16 (1909).

In the *Bridgewater* case the company issued stock expressly preferred as to dividends, but not as to assets. The Articles of Association contained no provision as to the distribution of assets on winding up. The Company was dissolved, and after all debts and expenses had been paid, and after repaying to the stockholders the amount of capital paid up, a balance remained. It was held that this should be divided among the shareholders, share and share alike. LORD MACNAGHTEN said at page 546:

"The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only

entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company.”

“* * * I think it rather leads to confusion to speak of the assets which are the subject of this application as ‘surplus assets’ as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company—part and parcel of the joint stock or common fund—which at the date of the winding-up represented the capital of the company. It is through their shares in the capital, and through their shares alone, that members of a company limited by shares become entitled to participate in the property of the company.”

In the case of *Lloyd v. Pennsylvania Electric Vehicle Company*, a New Jersey corporation, preferred stockholders, preferred only as to dividends, were paid on dissolution the full par value of their stock. The remaining assets were insufficient to pay the common stockholders in full. The court held that the assets should have been divided ratably among the preferred and common stockholders, since, when a corporation undertakes to set forth the preference to which preferred stock is entitled, instead of relying on the preferences given by statute, the preference must set forth fully, and so far

as no preference is expressed, the preferred stock can have no greater rights than the common stock. The Court said at page 267:

"Nor is any difficulty presented where the terms of the contract entitle the preferred stockholder to a preference in dividends only. In this case, which, as Vice Chancellor Van Fleet said, and as the authorities show, was the ordinary case, in the absence of such a provision as that contained in section 86, the preferred stockholders and the general stockholders would share *pro rata* in the distribution of assets after the payment of dividends due the preferred stockholders. That such would be the rule is well illustrated by a thoroughly considered case in the English courts * * *". (*Birch v. Cropper, supra*).

In the

FIDEL

APPEA

ALFRED
FREDER
ROBERT

No. 609.

FILED

JAN 18 1922

WM. R. STANSBURY

CLERK

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
Appellants,

v.

READING COMPANY, *et al.,*

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN
DISTRICT OF PENNSYLVANIA.

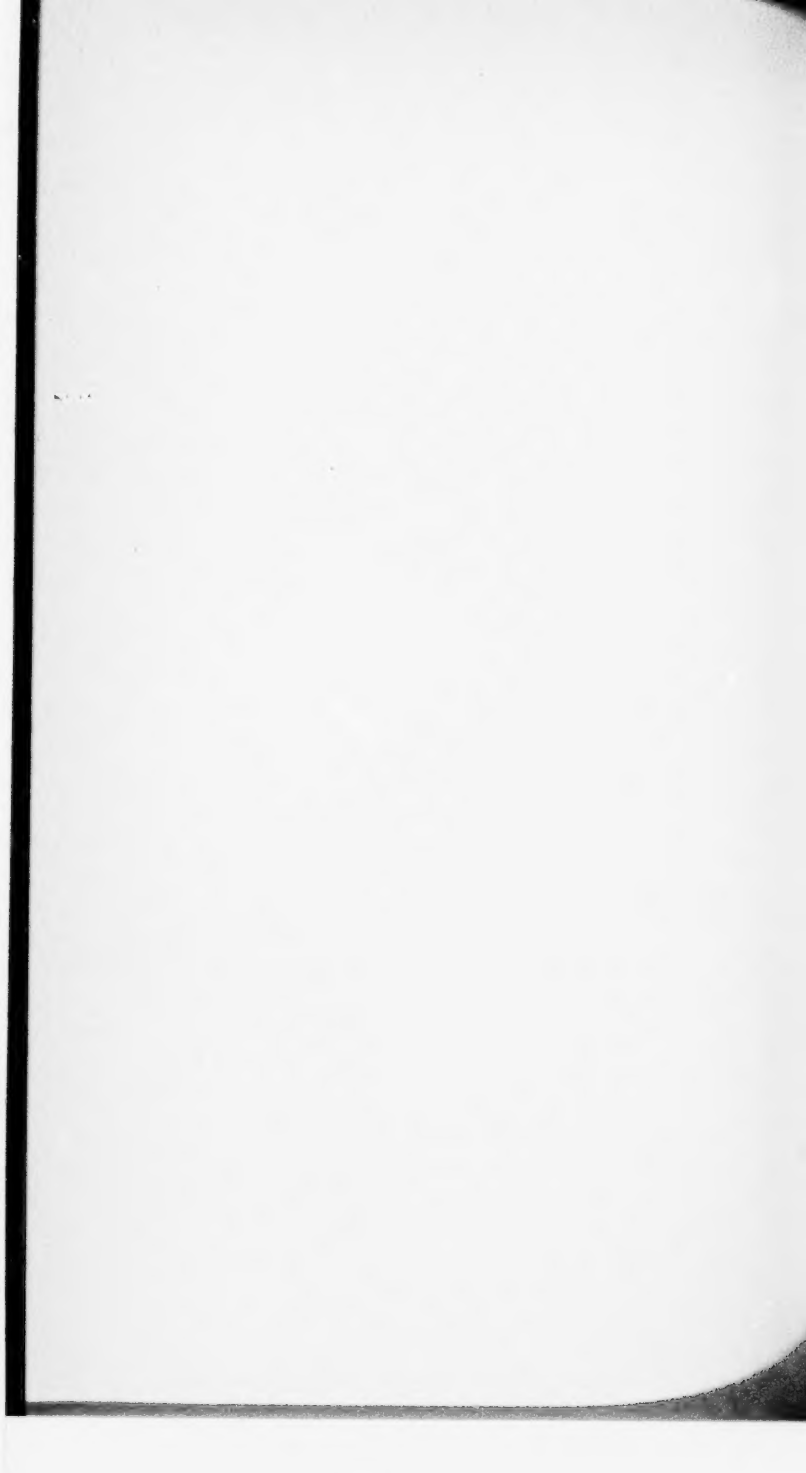
REPLY BRIEF FOR APPELLANTS.

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Supreme Court of the United States,

OCTOBER TERM, 1921.

No. 609.

CONTINENTAL INSURANCE CO., *et al.*,
Appellants,

AGAINST

READING COMPANY, *et al.*,
Appellees.

REPLY BRIEF

of

CONTINENTAL INSURANCE CO., ET AL., APPELLANTS.

Introduction.

These appeals were occasioned by that part of paragraph 5 of the Plan which provides (R. 275) :

“Such no par value stock will be *sold* by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000., or \$2.00 for each share of Reading stock” (*italics ours*).

In the Court below the appellees supported such sale and the Court approved it.

If what was decreed was a *real* sale for a proper consideration, the appellants would not be in this Court.

In the Court below and in their briefs submitted to this Court, the appellants contended that the method

adopted by the Reading Company was merely a pretense and was not a sale. The briefs of the appellees confirm this view. The Reading Company now protests that it did not in the Court below rely upon the *Union Pacific* dissolution to sustain the sale decreed in this case (although a reading of their brief in the Court below establishes the contrary). The view which the Reading Company now takes is that "the question of actual value" of the rights to the stock of the Coal Company "is not however of importance on these appeals." The appellees also concede in this Court that the right to purchase certificates of interest, denominated a right to "subscribe", is a valuable right, an admission inconsistent with the theory of a sale.

In short, the appellees have really abandoned the grounds upon which they supported the Plan in the Court below.* We recognize the exigencies which may at times compel the abandonment of a view taken in a court below on a question of law, but the question as to whether the transaction decreed in this case was or was not a sale, we submit, was then, and still is, not one of legal theory, but of fact. Lest there be any controversy over the principal ground upon which the Plan was supported in the Court below by the Reading Company we attach hereto, marked Appendix A, Point 1 of the brief of the Reading Company (and it is the Reading Company's Plan) and need only make reference to the Reading Company's answer to demonstrate that it was as a *bona fide* sale that it put forth the Plan and thereafter sought to support it (R 162-168, 169, 172).

The appellees seek reasons to support the form of a sale while abandoning its substance, as is evidenced by their briefs. That many of those reasons were not presented in the Court below, may very properly be re-

* The Iselin petition does not claim the Plan effects a dissolution. Its brief below mentioned a dissolution in fact.

The Kurtz brief below made a point that a dissolution was being effected.

garded as evidence of the necessities produced by the inability to support the theory upon which the Plan was devised and submitted to the Court below by the Reading Company.

The argument of the appellees is that the decree appealed from orders or involves a dissolution (not partial but complete) of the Reading Company, a dissolution in law, by reason of the merger of the Railway Company into the Reading Company; and in fact by reason of an alleged complete liquidation and winding up of the Reading Company's business. It is now contended that the essence of the Plan is neither distribution by way of dividend nor by way of sale, and that since complete dissolution of the Reading Company is involved all shareholders thereof should share and share alike. These contentions will be considered. Minor contentions are also advanced by the appellees, which, in the interest of brevity will not be considered in this reply brief.

I.

There is neither a dissolution in law nor in fact.

Confusion is attempted to be created by constant reference to "dissolution" of the combination in restraint of trade. It is well settled by the decisions of this Court that dissolution of a combination effected through a holding company does not require or involve the dissolution of a corporation. The Northern Securities Company was in itself, as was the reorganization of the holding company in 1896 in this case a violation of the Anti-Trust Act. The dissolution of the combination did not there, and does not here, require the actual dissolution of the holding company.

A corporation is a creature of a state under its sovereign powers. Dissolution thereof must proceed

through authority exercised by the State and in most cases through the action of the stockholders of the company. The decrees of Federal Courts do not dissolve a corporation created by a State. The Federal Courts may by mandatory injunction compel stockholders to vote for a dissolution or for dissolution proceedings to be instituted and effectuated. The Court below in this case undertook to compel no such action. Its decree was not intended to and does not compel specific action by the stockholders, but on the contrary requires the submission of the Plan to them for approval.

By the term "dissolution" under all the authorities can only be meant a death of the dissolved company, a surrender of its charter, a termination of the relationship between stockholders as such, and a distribution of all of the assets of the dissolved corporation after payment of debts. The term "dissolution" is capable of use in various connections and the definition is given in the interest of clarity of thought.

The plain facts are that the decree below neither requires nor involves a dissolution. The Reading Company, the very same defendant in this case, continues to exist. Its stockholders continue to retain precisely the shares of stock that they now own. The corporation does not wind up its affairs, it does not go out of business, it does not distribute all of its assets to its stockholders, nor even one-third thereof. It does indeed let go of one of its departments,—the coal business. It simply surrenders certain of the extraordinary powers conferred by its charter. Continuation under such charter, however, is far from death, and functioning as a going railway, is far from winding up. The corporation continues as the very same corporation, exercising the same powers which it may now exercise and does exercise, except that it has been deprived of its power to do mischief. Moral regeneration is not death.

Analysis of the decree below makes it almost too plain

for argument that the Reading Company, the defendant corporation in this case, continues in existence. In the introductory part of the decree reference is made to the "defendant Reading Company" (R. 287-290). Paragraph 2 of the decree provides that the Reading Company, the same as that previously referred to as the defendant, shall consummate the provisions of the modified Plan. The first paragraph of the modified Plan approved by the Court in its decree provides that the "defendants Reading Company * * * submit the following Plan", and proceeds to state that the Reading Company will assume the \$96,524.000 General Mortgage 4% Bonds, will agree to save the Coal Company and its property harmless therefrom (par. 4 of the Plan), will agree with the Coal Company that at or before the maturity of the General Mortgage bonds (January 1, 1997) it will obtain a release of the Coal Company's property from the lien of the General Mortgage. It would obviously be impossible for a dead corporation to carry out the terms of any such agreement (R. 274, 275).

That the Plan provided, and the Court below intended, that the defendant Reading Company should carry out the agreement mentioned, and not some new corporation, is plain from paragraph 5 of the Plan, for when a new corporation was intended, the terms "new corporation" were expressly employed.

The Plan further provides that the Reading Company, the same defendant herein "will accept the Pennsylvania Constitution of 1874". This provision is wholly inapplicable if it was intended thereby to refer to a new corporation to be formed. It would be wholly idle to require a corporation formed in 1922 to accept the provisions of a Constitution of 1874. Such language is only applicable to the defendant Reading Company, a corporation organized in 1871, and contemplated as existing under its 1871 charter after the proceedings contemplated in the present case are consummated (R. 276, 277).

The language of paragraph 6 of the Plan is definite, moreover, that the Reading Company's present charter is to be retained. Said paragraph 6 provides:

(R. 276) : "The Reading Company will *merge* the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company * * *". (Italics ours.)

The language is not that the Reading Company shall merge into the Railway Company (as stated in the brief on behalf of the Iselin Committee, pp. 5, 7, 29) ; not that the Reading Company and the Railway Company are to be consolidated into a third new corporation, but that the Railway Company is to be absorbed,

"under the authority contained in the present charter of the Reading Company."

The Plan is thus clear to the effect that the present charter is not to be surrendered, but is to be retained. Similarly, paragraph 6 of the Plan provides that the defendant Reading Company

"will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad company of Pennsylvania" (R. 272).

If the Reading Company is dissolved, as now contended, and a new corporation is created, whether as a result of merger or consolidation, it cannot surrender such powers. It can only assume powers, given to it on its creation. The terms of the Plan that the Reading Company is to "surrender those of its powers", are applicable and applicable alone to the present Reading Company.

Certain provisions of the decree are so simple in their contradiction of the contention that the present Reading Company is to be dissolved, as to make the contention to that effect amazing. The decree provides that "the defendant Reading Company, the Railway Com-

pany, and the Coal Company shall proceed with due diligence, etc." (R. 297), and that this same "Reading Company is enjoined from receiving etc." (R. 298, par. 7). It is the defendant Reading Company which is enjoined, not some new corporation not yet in existence. If the decree below had contemplated a new corporation it would have provided, as it provided in the case of the New Coal Company that such new corporation become a party defendant in the case and enter its appearance so that the Court may have jurisdiction (R. 295). The distinction between an existing company and a new corporation, where a new corporation is contemplated, is shown in paragraph 3-k of the decree as follows:

"The Reading Company and all persons acting for or in its interest are hereby perpetually enjoined from acquiring, receiving * * * any of the shares of the capital stock of the corporation; and the new corporation (*i. e.* the New Coal Company) and all persons acting for or in its interests are hereby perpetually enjoined * * *" (R. 295).

A dead corporation cannot be enjoined.

In dissolving the combination in restraint of trade we must accept the reorganization of the Reading Company in 1896 as an accomplished fact. The assets of the Reading Company have undergone a material and substantial change. In 1896 the assets of the Reading Company aggregated \$193,000,000 (R. 232), whereas in 1920 they aggregated approximately \$330,000,000 (R. 200). Changes equally material and substantial have taken place in the assets of the Coal Company (R. 198, 245).

All that the decree intended to do, was to separate the coal properties as they now exist from the Reading Company, and to strip the Reading Company of its power to violate the law.

Looking through the forms to the substance, the situation produced by the carrying out of the decree in this case is the same as that presented to the House of Lords

in *Will v. United Lankat Plantations Company*, and to this Court in the *Rockefeller* and *The New York Trust Company* cases. A branch of the business is segregated from the property of the corporation. The corporation continues to do business with the assets which it retains. In this case the Reading Company will obtain the income on the stocks and bonds which it owns and the revenue from the railway properties to which in substance it was heretofore entitled.

But the appellees say: "there is a merger of the Reading Company under the Pennsylvania Statute of 1909."

The Reading Company in its brief says:

(pp. 68, 69): "It becomes appropriate to examine just what this merger is in form and effect * * *; it becomes necessary indeed to do so for the appellants are under evident misapprehension about it."

Such misapprehension if it existed, would be fully justified. The only provision in the Plan with respect to the merger is to be found in paragraph 6 thereof which provides as follows (R. 276):

"The Reading Company will merge the Philadelphia and Reading Railway Company under the authority contained in the present charter of the Reading Company * * *"

There is no real assertion in the entire answer of the Reading Company of merger or consolidation. The brief of the Reading Company in the Court below will be examined in vain for any mention of any dissolution by reason of a consolidation or merger or the manner in which such merger would be effected.

The conclusion that a merger effects a dissolution is

bottomed upon the decision of the Pennsylvania courts in *Lauman v. Lebanon Valley Railway Co.*, 30 Pa. St. 42. That decision was followed in *Barnett v. Phila., etc., Market Co.*, 218 Pa. 649. The only significance of the reference to the *Lauman* case is that it establishes the right of a stockholder to enjoin a consolidation or merger until a deposit is made by the corporation with the court, sufficient to pay such stockholder the value of his stock, a doctrine peculiar to the law of Pennsylvania.

The briefs of the Iselin Committee and of Kurtz refer to the merger as taking place under the Pennsylvania statute of 1909. In point of fact, however, no merger under the statute of 1909 is ordered or required by the decree.

The Plan provides that the merger is by virtue of the authority in the original charter of the Reading Company. So far as the Reading Company is concerned no further authority was necessary. The argument now made by the appellees based upon proceedings under the Pennsylvania statute of 1909 is an afterthought.

The present contentions of the appellees are contrary to the statements in the answer of the Reading Company. The elaborate answer is that the Plan provides not a merger, not a consolidation, not a dissolution, but a simple sale of the Coal Company's stock.

But even assuming *arguendo* that the merger involves a technical dissolution of a corporation, the business, however, is not wound up, there is no distribution of assets and the rights accruing to stockholders upon dissolution are not brought into effect. The issue in this case is not to be confused by reference to the operation in a narrow and technical sense of a consolidation as a dissolution.

The rights of stockholders upon consolidation were fully considered in *Mayfield v. Alton Ry. G. & E. Co.*,

100 Ill. App. 614, affirmed in 198 Ill. 528. In that case the argument urged upon the court, which was practically the same as that urged here, was expressed by the Court as follows:

(p. 623): "The line of argument is, * * * that upon consolidation the constituent corporations as independent entities cease to exist * * * that a stockholder in such case has the right to have the assets converted into money * * * and that a consolidation of a corporation is a winding up of the constituent corporations."

So contending, the plaintiff there, upon a consolidation, sought to obtain the value of his stock. The court in that case made a complete answer to the contention of the appellees here, as follows:

(pp. 624, 625): "It is true, as counsel contends, that upon consolidation, all the duties and obligations of the constituent corporations, whether to the public or to private persons, are cast upon and must be performed and discharged by the consolidated corporation, but it was not the duty of the constituent corporation in which appellant held stock, to accept a surrender of his stock and pay him its value in money from the corporation assets, until such time as that corporation should reach the 'winding up' stage within the proper meaning. While for most purposes the constituent corporations cease to exist as independent entities, yet their corporate existence is not altogether ended, and regardless of legislation, in that respect they continue to exist, though under the new name, to such an extent as to preserve all their existing obligations unchanged, until in the fullness of time these obligations mature, and then the duty attaches to the consolidated corporation to pay, perform and discharge such obligation.

The winding up stage of the constituent corporations, within the meaning of these words as applied to the time for distribution of the corporate assets, is not accelerated by the consolidation, and therefore the mere fact of consolidation will not give the

stockholder the right to have the corporate assets converted into money; nor is such consolidation a *winding up of the constituent corporations, within the proper meaning of these words as applicable to the state of case set up in appellant's declaration.*" (Italics ours.)

In *Hale v. Cheshire Railroad Co.*, 161 Mass. 443, two railroads were authorized to consolidate on such terms as should be approved by the majority of each corporation. Each corporation had preferred as well as common stock. Consolidation was voted by the majority on the following terms:—each holder of four shares of the preferred stock of the Cheshire Railroad Company was to receive five shares of the preferred stock of the new company; and each holder of two shares of common stock was to receive one share of preferred stock of the new company. Two holders of common stock of the Cheshire Railroad Company brought a bill in equity to obtain their share of assets as upon a liquidation. In denying relief the Court said:

(p. 445) "The plaintiffs contend that common and preferred stockholders should stand on the same footing. That is true in the case of an ordinary liquidation or winding up of the affairs of a corporation, if there is nothing in the charter or articles to show otherwise; but the rule is not applicable to a case of consolidation like the present."

In the Matter of Interborough Consolidated Corporation, Bankrupt (District Court for the Southern District of New York, decided December 23, 1921, not yet reported), is a complete answer to the argument urged by the appellees that upon consolidation or merger, a dissolution in the sense of a winding up takes place. In that case a holder of preferred stock in one of the constituent companies, a New York corporation, filed a claim against the Consolidated Corporation based upon a provision in the certificate of incorporation of the constituent cor-

poration of whose stock he was a holder, and in the certificate of stock, which was as follows:*

"In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the Company, the holders of the preferred stock (before any amount shall be paid to the holders of the common stock) shall be entitled to be paid in full the par amount of their shares and interest thereon at the rate of five per cent. per annum from the date of such liquidation or dissolution or winding up, the unpaid dividends accrued on their said shares until said date, with interest on such dividends at said rate from the respective times at which the same accrued, and the proportionate part of the dividend accruing at said date with interest thereon at said rate from said date. After such payment in full to the holders of the preferred stock, the holders of the common stock shall be entitled to receive the remaining assets and funds in proportion to the shares held by them respectively."

The Court, resting its decision upon the opinion of the Supreme Court of Illinois in *Mayfield v. Alton Ry. G. & E. Co.*, *supra*, denied the claim. It must be clear that a provision in a stock certificate relating to a dissolution or winding up, does not contemplate a consolidation as within its terms. If a consolidation were within its terms we would reach the astounding result that a stockholder, either preferred or common, could vote in favor of a consolidation and then claim that under the provisions of the stock certificates he was entitled to the par value of his preferred or his common stock, as the case might be. No such result is ever intended by any such provision nor can it reasonably be contemplated.

* It is provided by Section 11 of the Business Corporations Law of the State of New York that a consolidated corporation assumes all the liabilities of the constituent companies. Under the law of the State of New York a consolidation effects a so-called "dissolution" of the constituent companies, *Miner v. N. Y. C.*, 123 N. Y. 242; *People ex rel. N. Y. Phone Co.*, 57 Hun, 486, *aff'd* on opinion below, 128 N. Y. 591; *Copp v. Colorado Coal & Iron Co.*, 29 Misc. 109.

In short, if the stock certificates in this case had specifically provided that upon any dissolution or liquidation or winding up, the holders of preferred and common would be entitled to an equal share in the assets of the corporation, suit could not be brought upon such provision of a certificate for the recovery of same, upon a consolidation of the corporation.

Whatever may be the effect of the merger, however, whether dissolution *vel non*, the distribution of New Coal Company stock is no part of such proceedings. A merger does not involve at all the actual distribution of such stock. The merger of the Reading Company and the Railway Company is one thing. This (so we assume *arguendo*), takes place under a Pennsylvania statute. The distribution of rights to New Coal Company stock, however, is quite another thing. It is this latter distribution to which the appellants object. The distribution of the New Coal Company stock is the unfair feature, and its demonstrated unfairness to the common stockholders is not altered by argument concerning another unrelated feature.

The matter may be made more clear by reference to the recent *Rockefeller* and *The New York Trust Company* cases. If in those cases, when the pipe line company stock was distributed to the oil company stockholders, the directors of the oil companies had gone through the extra flourish of merger with some other company, the distribution by way of dividend of pipe line company stock would have been none the less a dividend distribution.

The appellees contend further that the business of the Reading Company is liquidated in fact.

This is not true. The Reading Company is to retain by far the greater part of its present assets.* Its busi-

* The book value of the assets retained is \$330,033,190.85 less the value of the Jersey Central stock (\$26,000,000, R. 123) and the difference between \$77,000,000 and \$40,600,000 involved in the distribution of stock of the Coal Company.

ness continues. Simply one of its departments (a department which it never permitted to pay a dividend) is disposed of.

The Reading Company has admitted that such is the substance of the transaction. In its answer it says (R. 181) :

“The plan, if carried into effect, would dissolve the combination and deprive the Reading Company of its extraordinary powers and of its coal properties.”

Perhaps the appellees contend that the assets of the Reading Company, other than the stock of the Coal Company, are being distributed in liquidation, on the theory that such assets are represented by the present stock of the Reading Company, and such stock of the Reading Company will be distributed to the present stockholders. But retention by all the stockholders of their stock is no liquidation. If this be a distribution by way of liquidation, then any company may liquidate by simple declaration without further action. This is the very feature of the present plan which shows conclusively that there is no liquidation. A liquidation or winding up necessarily involves a termination of the relationship between stockholders as stockholders. If stockholders continue to be related to each other as stockholders in a going concern, their rights continue without change. It is only in a case where stockholders cease to be stockholders of the dissolved company, and no further business is done by it as a going concern, that the corporation can be said to be dissolved.

The brief on behalf of the Iselin Committee states that this Court in effect required a liquidation of the Reading Company, in its provision that the shares of stock and bonds of the various companies held by the Reading Company should be disposed of in such manner as might be necessary to establish the entire independence from that company and from each other of the various companies

involved.* But the opinion of this Court contemplates that the various companies shall continue to exist and function, for the language is that "the affairs of all those now combined companies may be conducted in harmony with the law" (R. 37). This is language looking not to death, but to continued existence.

The present theory of dissolution is only put forward on appeal in a further effort to bolster up the guise under which preferred stockholders of the Reading Company, although continuing that company in business, and retaining their identical shares of stock, distribute to themselves a handsome dividend above 4%. The common stockholders object "not on a narrow question of technical right", as contended by one of the appellees, but to the essence of that unlawful feature of the Plan which violates the contract between the stockholders.

II.

If it be assumed *arguendo* that the Plan contemplates a dissolution of the Reading Company, nevertheless the preferred is not entitled to share *pro rata* with the common in the distribution of the assets.

The appellees maintain that upon a dissolution, preferred and common shareholders share alike in the distribution of assets. We submit that no such conclusion is warranted by the stock certificates in this case.

Shares of stock are not abstractions but specific and concrete contracts. The stock certificates are the contracts. What do they say as to dissolution?

The one provision about which there is no controversy is that the preferred stock is limited to non-cumulative dividends not exceeding 4% per annum. Once

* Even after the disposal of such stocks and bonds the Reading Company would hold assets exceeding \$130,000,000.

the preferred stock has received its 4% dividends in priority to the common stockholders, it is entitled to no further participation in annual profits.

This limitation on the preferred stock is emphasized by that provision in the stock certificates which authorizes the Reading Company to redeem the preferred stock *at par*. Under this provision, however great may be the surplus of the Reading Company, the preferred stockholders would have to forego a participation therein.

The preferred stock was issued in 1896 in the main to previous creditors who were holders of Prior Preference Income Bonds of the old Company (R. 221-222). As holders of Income Bonds they had been entitled to non-cumulative interest not exceeding 5% per annum, payable only out of net earnings, if any, of the Railroad Company for the current fiscal year (R. 260-262). The failure of the Railroad Company to earn sufficient to pay such interest, forever destroyed any hope or prospect of the bondholders to obtain the interest for such fiscal year. The same rights were translated into preferred stock with this exception, made necessary by the slight difference in rights of bonds and preferred stock, namely, that as payment of interest is compulsory if earned, whereas the declaration of a dividend if earned is discretionary, the restriction was placed upon the use of net earnings of any previous year in which "full dividends" were not paid upon the preferred stock, so as to prevent an abuse of discretion. When the bonds matured the holders thereof would be entitled to the principal amount represented by the bonds. When the bonds were translated into preferred stock, it was not contemplated that the holders thereof should have their claims paid at more than par.

Since the preferred stock may be redeemed at par immediately prior to a dissolution, and a dissolution then effected whereby all of the remaining assets would be distributed exclusively to the common stock, it is not reasonable in any distribution of assets upon disso-

lution, if there be a surplus, that preferred receive more than par.

We regard it as clear under the contracts, that the holders of common stock are entitled to all of the annual profits after the payment of dividends of 4% to the preferred stock. Whatever doubt there may have existed upon the question must be regarded as removed by the practical construction acquiesced in by all interests for the period of ten years in which the common stock has received greater dividends than the preferred stock. If for any reason the Board of Directors has not declared all of the earnings in excess of 4% upon the preferred stock as dividends upon the common stock, why should the common stock be deprived of those earnings upon dissolution?

The Reading Company contends that there is no express preference or limitation of the preferred in the certificates in case of liquidation, and that therefore the preferred should share equally with the common. But the certificates are express in their limitations that the preferred may be redeemed at par and that it shall not receive profits "exceeding 4% per annum". The implication in case of distribution in liquidation is clear.

There is no case in the books which holds that preferred stockholders, expressly limited in their rights as they are in the instant case, are entitled to share equally with the common upon a dissolution.

The appellees' contention that upon dissolution the holders of preferred and common stock of the Reading Company share equally, rests upon *Birch v. Cropper* (*In re Bridgewater Navigation Co. Ltd.*), 14 A. C. 525, 1889)). Far from holding that upon dissolution preferred and common share equally, even where there is no express provision to the contrary, *Birch v. Cropper* held that upon dissolution, preferred and common share equally in increments of capital *only*, and upon the decision in that case, the Court of Appeal in *In re Bridge-*

water Navigation Co., L. R. (1891) 2 Ch. D. 317 (the very same case) held that before equal distribution is made to common and preferred stock, the annual profits of previous years represented not by separate funds or by property in specie but intermingled with all of the assets of the corporation, must be distributed wholly to the common stock.

We can even rest upon the decision of the Court of Appeal in *In re Bridgewater Navigation Co.* and the decision of the House of Lords in the same case, although we do not regard them as at all applicable to the situation presented here. The result of these decisions, when applied to the situation of the Reading Company is, that all annual profits which, if distributed, would have gone to the common stock in previous years, should be paid over to them prior to an equal distribution to the preferred and the common stock.

An analysis of those cases shows that they support our contentions and not those of the appellees.

In *In re Bridgewater Navigation Co. Ltd.*, 14 A. C. 525, the following was the situation. A fortuitous sale of the property of the corporation resulted in a large profit and the company *was actually wound up*. There were certain items which appeared upon the balance sheet as liabilities; these items were: a Canal and River Improvement Fund, an Insurance Fund, and a Depreciation of Steamers Fund.

These represented earnings of previous years which had not been distributed to the common stockholders who were entitled to receive them if they had been distributed.* The items were not represented by any specific property nor any ear-marked funds. The question which was submitted to the House of Lords was held to be:** After returning to the stockholders their contributions to the capital of the Company and subject to the adjustment of the

* L. R. 2 Ch. 317, 320, 326.

** L. R. 2 Ch. 317, 325, 330, 331.

rights of the preferred and common stockholders in the items which represented the earnings of previous years, what should be the rule governing the distribution of the remainder of the proceeds of sale of the property of the corporation?* That remainder obviously represented the increment in value resulting from the fortuitous and profitable sale. As to that part of the proceeds of sale, the House of Lords held the distribution should be made to preferred and common, share and share alike.** But as to any items which represented the earnings of previous years, not theretofore distributed, the Court of Appeal, in *In re Bridgewater Navigation Co. L. R.* (1891), 2 Ch. D. 317, held that funds equal to those items be distributed to common stockholders alone.

The Court of Appeal (Lindley, *L. J.*) said:

(p. 329): "The problem is no longer what is to be done in the way of dividing the profits of a going concern; the problem now is, how much of the whole assets of the company belongs to one class of shareholders, and how much to another; and if it appears that some of those assets consist of undrawn profits of one of those classes, such undrawn profits ought to be distributed amongst the members of that class, unless some sufficient reason to the contrary can be shown."

The items which were dealt with by the Court of Appeal represented items similar to the surplus of the Reading Company. Upon any dissolution, such annual profits as would have been distributed to the holders of common stock alone if distribution had been made, must be paid to the holders of the common stock prior to any equal distribution to preferred and common.

There is no contention that there has been any increment in the value of the original investment of the Reading Company other than through accumulation of earnings. The surplus of the Reading Company as well as the

*See also North, *J.*, in *In re Bridgewater Navigation Company*, *L. R.* (1891) 1 Ch. 155, 164, 165.

**See *L. R.* (1891) 2 Ch. 317, 325, 330, 331.

surplus of the Coal Company and the Railway Company are the result of the annual accumulation of earnings (R. 62, 259).

In none of the cases in the Courts of this country cited by the Reading Company or the other appellees was the court called upon to determine the rights of preferred and common stockholders, in assets sufficient in amount to leave a surplus after payment of the par value of the preferred and common stock.

Lloyd v. Penna. Vehicle Co., 75 N. J. Eq. 263, merely held that preferred stock was not entitled to a preference out of assets where no preference was expressly given. Nothing that the court said in its dictum can be interpreted to mean anything other than upon distribution, the holders of common stock are entitled to the annual profits remaining after payment of the preferred dividends to holders of preferred stock, and that the remainder of the assets should be distributed equally between preferred and common stock which appears very clear from the interpretation of the Court of the decision of the House of Lords in *re Bridgewater Navigation Co., Ltd.*, 14 A. C. 525, of which the court said:

(p. 268) : "The common stockholders insisted that the whole of this surplus was profits, and that, as they were entitled to all of the profits after paying the 5 per cent to the preferred stockholders, they were entitled to the whole of the fund. The court, however, held that this position was untenable, and that the rule contended for by the common stockholders applied only to annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect the decree was affirmed by the House of Lords, but it was there held that the surplus should be divided among the stockholders in proportion to the number of shares held by each, and not in proportion to the amount contributed by each."

Jones v. Concord & Montreal Railroad Co., 67 N. H. 119, merely involved the issuance of additional stock by a corporation, not a distribution of assets upon dissolution.

The question as to the rights of the preferred and common upon dissolution we respectfully submit cannot be affected by the *ex parte* statement of the Reading Company made to the New York Stock Exchange for the listing of the stock of the Reading Company, eight years after the re-organization of the Reading Company and the authorization and issuance of the preferred and common stock. The holders of common stock were not parties to that declaration and have never acquiesced therein and no conduct has been alleged from which any acquiescence can be even implied. The rights of the preferred stockholders as against the holders of common, cannot be established, by *ex parte* statements made by the Reading Company in the listing application to a private exchange whose records are not public records and whose activities are not subject to any public regulation.

III.

Assuming, *arguendo*, that the preferred stock shares equally with the common on dissolution, and further that a merger in this case would involve a dissolution, nevertheless the preferred stockholders are not entitled to share in the distribution of stock of the New Coal Company.

The rights of shareholders *inter sese* are not the same on a dissolution which is incident to a merger or consolidation, as on a complete dissolution and winding up of the corporation's business (*supra*, pp. 9-13).

The truth is that the doctrine of those cases which hold (in construing certificates of stock differing from those of the instant case) that upon a *real* dissolution and winding-up, the preferred and common share alike, is based upon the essential feature that the corporation no longer continues in an enterprise for profit and that the relationship between the stockholders as stockholders

is terminated. If through any device of reorganization, whether it be merger or consolidation, and whether a dissolution of the reorganized companies be involved or not, the former stockholders continue to participate in a going enterprise run for profit, the principles involved in *real* dissolution have no application.

This is the doctrine of the reorganization cases. See *Northern Pacific R. R. v. Boyd*, 228 U. S. 482; *Hale v. Cheshire Railroad Company*, 161 Mass. 443 (*supra*, p. 11); *Mayfield v. Alton Ry. G. & E. Co.*, 100 Ill. App. 614 (*supra*, pp. 9-11); *Southern Pacific R. R. Co. v. Bogert*, 250 U. S. 483; *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590; *Jones v. Missouri Edison Electric Co.*, 144 Fed. 765.

Thus in the *Bogert* case, 250 U. S. 483, the Court protected the interests of stockholders of corporations which had been reorganized. In the *Geddes* case, 254 U. S. 590, the Court protected a minority stockholder against an unlawful sale even though dissolution of the corporation was involved in the plan of the majority.

As was said by the Court in *Jones v. Missouri Edison Elec. Co.*, 144 Fed. 765, the duty of the majority to conduct themselves as trustees for the minority holds both in a sale of the property of the corporation and in a consolidation (p. 771).

How easy it would be for majority to oppress minority stockholders by forming a new corporation in which the majority would participate to the disadvantage of the minority, if they could support such a plan by the device of only technical dissolution involved in a merger or consolidation!

The essence of the present case is the distribution, in one form or another, of extremely valuable rights of the corporation to preferred stockholders who continue as such in the going concern operated for profit, and whose certificates provide that distribution to them shall be limited to 4% per annum.

IV.

The Memorandum Filed on Behalf of the Government.

It must be conceded that the question raised by the appeal as the Government correctly says is not one

"in which the United States has a direct or special interest."

It does not appear from the memorandum that the Government is in any wise prejudiced by a modification of the decree which contemplates justice to the common stockholders. It is quite difficult to conceive how the Government can at all be interested in whether certificates of interest in the stock of the New Coal Company are given wholly to the common stockholders or distributed equally to preferred and common.

The question involved on this appeal is not whether discretion was properly exercised by the Court below. The Court below might have approved a plan for a distribution of stock to shareholders entitled thereto (Main Brief, p. 21). Were there a *real* sale in this case, it might well be argued that any discretion of the Court as to the persons who should purchase the stock of the New Coal Company should not be interfered with. But the division of the stock of the New Coal Company or certificates of interest therein, to holders of preferred and common, share and share alike, was not a matter which involved discretion as to the manner in which the mandate of this Court should be carried out. This Court has never approved, and the courts have never enforced, any plan for a dissolution of a combination in restraint of trade which has impaired the relative rights of preferred and common stockholders. And the Court below did not intend to impair such rights. The division to common and preferred was approved on the theory that it did not prejudice the legal rights of the classes of stockholders. It was not an exercise of discretion, but an adjudication of rights.

The controlling factors enumerated by this Court in *United States v. American Tobacco Co.*, 221 U. S. 106, 185, to which the Government makes reference, do not require that certificates of interest in the stock of the New Coal Company shall be distributed equally to preferred and common, because

1. a complete and efficacious effect to the prohibitions of the Anti-Trust Act is given, irrespective of the distribution as between preferred and common; 2. the general public is not affected by the question of whether or not the distribution is made to holders of preferred or common, or to either, but the public interests are prejudiced by permitting injustice to be done under the guise of a decree of this Court; 3. upon the question of a proper regard for the interests of private property which have become vested in many persons, the Court below determined that the legal rights were not impaired by the Plan, and that presents the question on this appeal.

The point is made that the Plan should be approved, notwithstanding an injury to the legal rights of the common stockholders, because the result has proved satisfactory to the vast majority of Reading stockholders. The New York Central Railroad Company and the Baltimore & Ohio Railroad Company unquestionably approve the Plan. Eliminating the New York Central and the Baltimore & Ohio, it appears that of the preferred stock held by independent holders, 39% have appeared to approve of the Plan, and that of the holders of common stock (other than the New York Central and the Baltimore & Ohio) 41% have appeared to oppose the Plan. No inference can be drawn from the fact that 41% having appeared to oppose the Plan, that the other 59% approve of it. It may with equal cogency be argued that the holders of 61% of the preferred stock who have not appeared are in no way interested in the question of how the "rights" are distributed as between the preferred and common

stock. The fact is that there is a large floating supply of stock of the Reading Company preferred and common, and it is unnecessary where representatives of so substantial a part of the common stock appear to object to a plan, that the other holders personally be represented. This Court has given effective protection to a minority, less substantial in amount than is represented by the appellants.

With respect to the holder of 100,000 shares of common stock who at this time approves the Plan, it may well be said that he still manifests his approval, although he at one time objected to the Plan and authorized the Prosser Committee to appear for him (R. 150).

It is further said in the memorandum filed on behalf of the Government that relief should not be granted to the common stockholders because of any "technical" right as between different classes of stockholders.

We respectfully submit that the characterization of the legal rights of the common stockholders as "technical" must proceed from a failure to appreciate the facts of the case. (See Main brief, pp. 5-17.)

Furthermore in addition to the stock of the Coal Company, the Reading Company must dispose of the stock of the Jersey Central in which the Reading Company has an equity of \$26,831,800 (R. 123—Lehigh-Wilkes-Barre Coal Company and Jersey Central). It must also dispose of the stock of the Reading Iron Company in which the Reading Company has an equity (R. 123) of \$22,791,500. (Constitution of Penna., 1874, Article 17, Section 5, R. 18.)

If the Court in this case will permit the distribution of the surplus of the Reading Company to preferred and common share and share alike, similar distribution will be made with respect to the proceeds of the stock of the Jersey Central and of the stock of the Reading Iron Company. Nor will the matter end there. The Reading Company may at some time conclude that holding the \$25,000,000 of new 4% Mortgage bonds of the Coal Com-

pany, may involve legal difficulties and conclude that such bonds should be distributed. Yet the surplus of all the companies combined is sufficiently large to enable all such distributions to be made out of surplus without in anywise impairing the capital of the Reading Company.

Or, if the argument of the Reading Company is sound, the Reading Company may convey its surplus to a new corporation and distribute its stock equally to preferred and common. The result of such conduct will be ultimately that the preferred stock will retain its right to 4% non-cumulative preferred dividends, and will acquire in addition annual dividends equal to that of the common stock. The reduction of surplus is an injury to the common stock; it leaves the preferred stock and its right to dividends unimpaired.

If the distribution in this case is sustained, the Reading Company controlled by the preferred stockholders may refuse to pay dividends on the common stock or dividends of only 4% per annum, allow the surplus (representing earnings which if declared as dividends go to the holders of common stock alone) to accumulate, and then when some pretext arises for such action, dispose of assets equal in value to the surplus and distribute the same alike to preferred and common.

We respectfully submit that the characterization of the rights of common stockholders as "technical" in this case, can proceed only upon a failure properly to measure the injury which the Plan approved by the Court below, inflicts upon the holders of common stock.

Respectfully submitted,

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APPENDIX A.

(From brief of Reading Company submitted to the Court below.)

POINT 1. The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature.

It is the real nature of the transaction and the character of the asset disposed of, not the effect of such disposition on the books of the company, which determine the rights in respect of such disposition.

United States v. Union Pacific Railroad Company, 226 U. S. 61 (1912).

United States Trust Company of New York v. Heye, 181 A. D. (N. Y.) 544; 224 N. Y. 242 (1918).

It seems advisable to set out in some detail the facts in connection with the dissolution of the combination between the Union Pacific Railroad Company and the Southern Pacific Company and the dissolution of the Standard Oil Trust, in connection with which these cases arose.

A. The Union Pacific Case.

(a) The Union Pacific Railroad Company is a corporation of the State of Utah, having both preferred and common stock. Prior to 1908, the Union Pacific owned all the stock of the Oregon Short Line Railroad Company, which in turn owned \$126,650,000, par amount, of the stock of the Southern Pacific Company or about 46% of the outstanding stock. In that year, the Government brought suit against the Union Pacific, the Oregon Short

Line and other defendants, alleging a combination in restraint of trade in violation of the Sherman Act. In 1912 the Supreme Court held that an illegal combination existed, and directed that a plan providing for the disposition of the Southern Pacific stock should be filed with the District Court for the District of Utah. *United States v. Union Pacific Railroad Company, supra.*

Thereafter, various plans were submitted to the District Court and on June 30, 1913, that Court entered a decree approving the sale of \$38,292,400, par value, of the Southern Pacific stock to the Pennsylvania Railroad Company in exchange for \$42,547,200, par value, of the stock of The Baltimore and Ohio Railroad Company, half preferred and half common, and directing that the remaining shares (883,576) should be transferred to Central Trust Company of New York, as Trustee, and that the right to subscribe to certificates of interest representing such shares should be offered to all stockholders of the Union Pacific, common and preferred, *pro rata*, at such price as the Union Pacific should determine.

Pursuant to this decree the Union Pacific offered its stockholders, preferred and common, the right to subscribe ratably to such certificates of interest at \$88 a share, and accrued dividends. At the time of this distribution the Southern Pacific had a surplus of more than \$60,000,000.

(b) Thereafter the Union Pacific declared an extraordinary dividend on its common stock consisting of the following amounts on each share: 1. three dollars in cash; 2. twelve dollars, par value, of preferred stock of the Baltimore and Ohio; 3. twenty-two and a half dollars, par value, of the common stock of the Baltimore and Ohio. The regular dividend on the common stock was at the same time reduced from 10% to 8%, the reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provide:

"The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company to dividends in each and every fiscal year at such rate not exceeding 4 per cent. per annum, payable out of net profits, as shall be declared by the Board of Directors.

Such dividends are non-cumulative and such Preferred Stock is entitled to no other or further share of the profits."

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, and that, as the preferred stockholders, having received 4% dividends, were entitled to no other or further share of the profits, the dividend was properly declared to the common stockholders.

The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Company, 162 A. D. (N. Y.) 81, 212 N. Y. 360 (1914).

B. The Standard Oil Dissolution.

Prior to 1911 the Standard Oil Company of New Jersey owned the stock of thirty-three subsidiary companies. In that year, on the suit of the Federal Government, a decree was entered in the United States Circuit Court enjoining the continuance of this unlawful combination and permitting the Standard Oil Company to distribute the stocks of its subsidiary companies among its own stockholders. Thereupon the directors resolved that the stocks of subsidiary companies be distributed among the stockholders of the parent company and that the book value of the stocks distributed be charged to "Reserve Profits." The rights arising out of this distribution were considered by the New York Courts in *United States Trust Company of New York v. Heye, supra*.

This case involved the rights of a life tenant and remainderman under a trust created in 1899. Most of the stocks distributed had originally formed part of the trust estate, and had been exchanged for stock of the Standard Oil Company of New Jersey. The book value of the Standard Oil stock, December 31, 1899, was \$202.32 per share. Before the distribution of December 1, 1911, accumulated earnings had brought the value up to \$566.67, and after the distribution the book value was \$281.72 per share. Therefore, the "Reserved Profits" account against which the distribution was charged consisted largely of earnings accumulated since the creation of the trust. The subsidiaries whose stock was distributed also had large accumulated earnings. The Court said that earnings accumulated since the creation of the trust went to the life tenant, but nevertheless held that the remainderman was entitled to all the stock so distributed except that which had been actually acquired by the Standard Oil Company out of earnings accumulated since the creation of the trust.

C. Application of Foregoing Cases to Point 1.

The difference between the rights of stockholders in case of a sale and their rights in case of a dividend is shown by the two cases arising out of the Union Pacific dissolution proceedings. In the Baltimore and Ohio stock distribution case, *The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Company*, *supra*, the court held that the Baltimore and Ohio stock distributed (a part of which had been received in exchange for Southern Pacific stock) represented profits of the Union Pacific, and accordingly, when distributed by way of dividend, was properly given to the common stockholders exclusively. In the dissolution proceedings, however, when the transaction in question was a *sale*, the

Court directed that the remaining Southern Pacific stock be sold to preferred and common stockholders, *pro rata*.

In the *Heye* case (Standard Oil dissolution) the Board of Directors had resolved that the book value of the stocks distributed should be charged to "Reserve Profits", which consisted in large part of earnings accumulated since the creation of the trust. (See p. 4.) The Court stated the rule that earnings accumulated since the creation of the trust belonged to the life tenants, but nevertheless held that the remainderman was entitled to all the stocks which had originally formed part of the principal of the trust in spite of the fact that the distribution reduced the amount of surplus shown on the books and available for distribution in dividends to the life tenant.

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IN THE

Supreme Court of the United States

October Term, 1921, Nos. 609, 610

CONTINENTAL INSURANCE COMPANY, *et al.*, *Appellants*,

VS.

READING COMPANY, *et al.*, *Appellees*.

SEWARD PROSSER, *et al.*, as a Committee, etc., *Appellants*,

VS.

READING COMPANY, *et al.*, *Appellees*.

ON REARGUMENT

Brief for Adrian Iselin, *et al.*, a Committee Representing Preferred Stockholders, *Appellees*

We shall first analyze the Plan and Decree and then proceed to a discussion of the questions assigned by the Court for consideration.

Analysis of the Plan and Decree.

(a) *Considerations Exchanged by the Reading Company and the New Coal Company (R. 275-276).*

The Reading Company

(1) transfers all its interest in the stock of the *old* Coal Company to the *new* Coal Company;

(2) agrees to save the *new* Coal Company and the stock of the *old* Coal Company which it transfers, harmless from the lien of the general mortgage;

(3) agrees to obtain the release of the stock of the *old* Coal Company from the lien of the general mortgage at or before the maturity of such mortgage;

(4) agrees at that time to obtain the delivery of the stock of the *old* Coal Company to the *new* Coal Company.

In consideration of the foregoing, the *new* Coal Company

(1) pays the Reading Company \$5,600,000, and

(2) agrees to issue certificates of interest in its stock to the stockholders of the Reading Company, these certificates to be exchangeable for stock in the *new* Coal Company when accompanied by a suitable affidavit and upon the payment provided for.

The payment may be explained as follows:

The Reading Company has outstanding \$70,000,000 par value of first and second preferred stock, and a like amount par value of common stock, a total of \$140,000,000 or 2,800,000 shares of stock, as all shares have a par value of \$50.

The sum to be paid, to wit, \$5,600,000, divided by the number of shares outstanding of the Reading Company, to wit, 2,800,000, equals \$2.00 per share.

The *new* Coal Company is to issue 1,400,000 shares of stock without par value. It is obvious that as this no par value stock is to be sold by the new Coal Company to the stockholders of the Reading Company, preferred and common, share and share alike, each holder of one share of the Reading Company will be entitled to receive one-half a share of stock of the new Coal Company on payment of \$2.00. In other words, one share of stock of the new Coal Company will cost \$4.00, but in order to purchase one share, the purchaser will have to hold two shares of the Reading Company (R. 275).

(b) *Considerations Exchanged by the Reading Company and the Old Coal Company (R. 275).*

The Reading Company

(1) assumes the entire obligation to pay \$96,524,000 general mortgage 4 per cent. bonds due January 1, 1997;

(2) agrees to save the *old* Coal Company and its property harmless therefrom;

(3) agrees that at or before maturity of the general mortgage bonds, it will obtain the release of the property of the *old* Coal Company from the lien of the general mortgage and the discharge of the *old* Coal Company from liability on the general mortgage bonds;

(4) agrees to execute to the *old* Coal Company a general release of all claims and liabilities. This will include the claim of approximately \$70,000,000 now carried on the books of the Reading Company as an asset and on the books of the *old* Coal Company as a liability.

The *old* Coal Company

(1) pays to the Reading Company (a) \$10,000,000 in cash or current assets at market value, and (b) \$25,000,000 in 4 per cent. mortgage bonds of the *old* Coal Company;

(2) agrees to give the Reading Company a general release of all claims and liabilities.

(c) *Provisions Which Safeguard the Issue of the Stock of the New Coal Company and Make Impossible the Recreation of a Similar Combination.*

The stock of the new Coal Company in the first instance is to be issued to trustees appointed by the court (R. 292); the trustees are to issue certificates of interest

which shall be offered for subscription to the stockholders of the Reading Company, preferred and common, share and share alike (R. 292). A copy of the certificate of interest is printed in the record, pages 302 and 303.

A stockholder of the Reading Company may obtain delivery of a certificate of interest upon payment in full of the subscription price, to wit, \$2.00 per share of Reading Company or \$4.00 per share of the new Coal Company.

The certificate of interest (R. 302) states that the trustees have received and hold for _____, or assigns _____ shares of the capital stock of the new Coal Company, subject to the terms of the decree entered in this cause, to which reference is made, and "to which decree the holder of this certificate assents by acceptance hereof." The certificate of interest further states that the owner of thereof is entitled to receive _____ shares of stock of the new Coal Company, upon filing with the trustees an affidavit that he does not own any shares of the capital stock of the Reading Company and is not acting for stockholders of the Reading Company or in concert with other persons for the control of the new Company in the interest of the Reading Company (R. 303).

Neither the Reading Company nor any corporation controlled by it nor any person acting in its interest may acquire by purchase or otherwise any of the certificates of interest issued by the trustees (R. 292).

A registered owner of such a certificate of interest which, as stated, will be issued by the trustees appointed by the court, may obtain an exchange of the certificate for an equivalent number of shares of the *new* Coal Company when he files with the trustees a properly executed affidavit in one of the forms provided in the decree. These forms are printed in the record, pages 305 to 308.

The affidavit which the applicant must execute as a condition of exchanging the certificate of interest for

shares of stock in the new Coal Company, declares that the applicant is a *bona fide* owner of the certificate of interest; that he does not own any shares of the capital stock of the Reading Company and he is not acting for or on behalf of any stockholder of the Reading Company or in concert or agreement with any other person, firm or corporation for the control of the Reading Company, but is acting in good faith in his own behalf (R. 305).

(d) Reports to the Attorney-General.

The decree requires the trustees to report monthly to the Attorney-General the amount of certificates of interest surrendered for exchange for shares of the new Coal Company. At any time, upon the request of the Attorney-General, the trustees shall furnish him with any additional information which he may require relative to the carrying out of the decree (R. 294).

I.

The First Question.

The first question, which we understand the Court desires to be considered, is:

“Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court.”

The decree on the mandate directed the defendants to submit a plan for dissolution of the unlawful combination between the five companies existing and maintained

through the Reading Company, with such provisions for the disposition of the shares of stock and bonds and other property of the various companies held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other of the Railway Company, the Coal Company, etc. (R. 36-37).

The modified plan will be found in the record, pages 274 to 277, and the decree will be found at pages 287 to 312. It is necessary to examine each of the references just given, as the plan was not reprinted in the decree although it forms a part of the decree (R. 290).

We shall assume that the plan has been put into effect, and shall describe what we understand to be the condition produced thereby.

(a) The Companies as they will be after the Plan has been completed.

The Reading Company, the holding company, has passed out of existence. It has merged with the Philadelphia and Reading Railway Company and surrendered those peculiar powers which it held under its special charter and which were inappropriate for a railroad corporation of Pennsylvania, accepted the Pennsylvania Constitution of 1874 and has received new letters patent from the Governor creating it a railroad corporation subject to State and Federal authorities as a common carrier, no longer possessing any extraordinary powers (R. 277). Penna. Laws 1909 (P. L. 408). As we pointed out in our original brief (pp. 28 *et seq.*) filed herein, in effect the pre-existing Reading Company has been terminated, its affairs liquidated, and an entirely new corporation created to own and operate the railroad.

A new Coal Company also has been formed and to that company the Reading Company has transferred the stock of the old Coal Company, subject, however, to the lien of the existing general mortgage (R. 291).

The new Coal Company has obtained the right to vote on the stock of the old Coal Company (R. 291). The old Reading Company has ceased to exist and the new Reading (Railway) Company can never obtain the right to vote the stock of the old Coal Company. The Reading Company also has executed and delivered to the trustee of the general mortgage an irrevocable order directing it to deliver to the new Coal Company a suitable power of attorney to vote the stock of the old Coal Company. The trustee has executed and delivered such proxy or power of attorney to the new Coal Company. This proxy can be terminated only by default under and foreclosure of the general mortgage. In the event of such default, and sale under foreclosure the coal properties and the railway cannot be acquired by the same interest, because the decree expressly prohibits this (R. 298, par. 6).

While the new Coal Company is in possession of the right to vote the stock of the old Coal Company, it is enjoined from voting the same in such a way as to bring about any new relations between the Railway Company and the old Coal Company of the character complained of (R. 276; R. 295 #J).

(b) The Lien of the General Mortgage Is Unimportant.

The capital stock and the coal properties of the old Coal Company remain subject to the lien of the general mortgage which was executed in 1896 by the Reading Company and the old Coal Company. The stock certificates are held by the trustee of that mortgage which covers also certain railway properties.

The new Reading (Railway) Company has assumed all liability for the general mortgage bonds and has agreed to save the old Coal Company and its property harmless therefrom (R. 274, par. 1). The new Reading Company also has agreed that when the general mortgage bonds mature, January 1, 1997, or sooner, it will obtain the

release of the old Coal Company's *property* from the lien of the general mortgage and will, also, obtain the discharge of the old Coal Company from liability on the general mortgage bonds (R. 275, par. 4). The old Reading Company and the new Reading (Railway) Company also has agreed to protect the stock of the old Coal Company from the lien of the general mortgage, and furthermore has agreed to obtain the release of the *stock* of the old Coal Company from the lien of the general mortgage at its maturity or sooner, and to procure delivery of the stock to the new Coal Company (R. 275, par. 5).

The injunctive provisions of the decree have made it impossible for the coal properties and the railroad properties to be brought together under a single ownership or control, in the event of default and sale under the general mortgage. For the decree provides (R. 298, par. 6). that in the event of default under the general mortgage, the trustee shall exercise the right to vote the stock of the old Coal Company in such a way as not to bring about unity of management between the old Coal Company and the Reading Company, now the Railway Company. The court also has directed that in the event of a sale under the general mortgage of the stock or coal properties of the old Coal Company, the trustee shall dispose of such stock and properties separately from the properties of the Reading Company—the Railway Company—and to different interests (R. 298, par. 6).

(c) *Additional Injunctive Provisions to Insure a Permanent Separation of the Coal Properties and the Railroad.*

The names of the officers and directors of the new Coal Company have been submitted to the court for approval (R. 291, par. 3a).

No officer or director of the new Coal Company may be an officer or director of the new Reading Company.

The new Coal Company has been obliged to enter its appearance in this cause by counsel and to submit itself to the jurisdiction of the court for all purposes of this cause (R. 291). This appearance was required of it before the transfer of the interest in the stock of the old Coal Company.

The new Coal Company, pursuant to the decree, has become a party defendant to this cause and subject to the provisions of this decree (R. 291).

The new Coal Company and its officers and directors have been enjoined from exercising the voting power in the stock of the old Company so as to form a combination between the old Coal Company and the new Reading (Railway) Company—such as has been adjudged unlawful (R. 295J).

Never again can the company owning the coal mining enterprise and the company owning the railroads enter into close corporate relations. The decree has provided against this, for it has permanently enjoined the old Coal Company from issuing to the new Reading Company and the latter company from receiving any stock, bonds or other evidence of corporate indebtedness of the old Coal Company in addition to the \$25,000,000 of 4 per cent. bonds referred to above (R. 297, par. 7).

Furthermore, the Reading Company, now the Railway Company, can never acquire control of the *new* Coal Company or purchase the stock of that company. This is expressly inhibited by the decree.

For Paragraph "K" of Section 3 (R. 295) provides:

"The Reading Company and all persons acting for and in its interest are hereby *perpetually* enjoined from acquiring, receiving, holding, voting or in any manner acting as the owner of any of the shares of the capital stock of the new corporation."

How can there be a clearer prohibition against the Railway Company ever acquiring any interest in the *new* Coal Company?

During the period allowed for the conversion of the certificates of interest into stock of the new Coal Company, no present stockholder of the Reading Company may be a purchaser of stock of the new corporation if still a stockholder of the Reading Company. [Paragraph "I," Section 3 (R. 295).] That is to say, a stockholder of the Reading Company, may not during this period purchase on the market stock of the new Coal Company as long as he remains a stockholder of the Reading Company.

In order to ensure enforcement of this provision, it is provided that

"The Attorney-General of the United States shall have access to the stock transfer books of the Reading Company and the new corporation for the purpose of enabling him to enforce compliance by such stockholders with this provision of this decree" (R. 295, par. I).

Nor may the *new* Coal Company ever acquire stock of the new Reading Company. This is prevented by Paragraph "K," Section 3 (R. 295), which "*perpetually* enjoins the new corporation and all persons acting for or in its interest from acquiring, receiving, holding, voting, or in any manner acting as the owner of any of the shares of the capital stock of the Reading Company."

II.

The Second Question.

The second question suggested by the Court is as follows:

"2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for sale of the Coal Company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage."

It will be noted that the foregoing question relates to freeing from the mortgage the *stock* of the old Coal Company, and makes no reference to the *properties* of the old Coal Company. The general mortgage of 1896 of the Reading Company (to which the old Coal Company was also a party) covers all the coal properties as well as the stock of the old Coal Company.

The record does not contain a copy of the general mortgage. A sufficient description of it, however, will be found on page 217 and also at pages 239 and 240; the first reference being to the plan of reorganization and the second being contained in the application to list on the New York Stock Exchange.

(a) *As to the lien of the contemplated new mortgage.*

The question is whether there is any legal or practical difficulty in providing for the sale of the Coal Company's stock free from the lien of the contemplated new mortgage. The statement of this question indicates a misapprehension. The stock of the *old* Coal Company will not be subject to the lien of the contemplated new mort-

gage. It is the *old* Coal Company, not the *new* Coal Company which is to give \$25,000,000 of mortgage bonds to the Reading Company when the latter becomes a railroad company. If the contemplated new mortgage were being executed by the *new* Coal Company, doubtless such a mortgage would have to rest upon the interest in the stock of the *old* Coal Company possessed by the *new* Coal Company. But, as stated above, the plan provides for the mortgage to be executed by the *old* Coal Company, which, of course, can be carried out without subjecting the stock of the *old* Coal Company—that is, the stock of the obligor under the new mortgage—to the mortgage.

(b) There is no danger of the unlawful combination being recreated in the event of a default on the new \$25,000,000 mortgage or default on the general mortgage.

It is the *old* Coal Company, not the *new* Coal Company which gives \$25,000,000 of mortgage bonds to the Railway Company. This new mortgage matures January 1, 1997, the same day as the general mortgage matures.

It is to be remembered that an essential feature of the plan is the provision for the consolidation of the Reading Company and Railway Company, and the surrender by the Reading Company of its special powers, the Reading Company becoming a railroad corporation. Therefore, even if there should be a default on the new mortgage, January 1, 1997, the beneficiary of the mortgage, namely, the Reading Company, will not be able to purchase the coal properties of the old Coal Company on a sale under the new mortgage. This would be forbidden by the laws of Pennsylvania, which prevent a railroad company owning coal properties.

We think that the provisions of the decree elsewhere analyzed are sufficient to prevent the recreation of the combination in the event of any such sale. But if the

decree is not broad enough to accomplish that result, it is accomplished by the laws and Constitution of Pennsylvania (R. 18).

On January 1, 1997, when the general mortgage and the proposed new mortgage mature, the situation will be as follows:

The Central Union Trust Company, trustee of the general mortgage, will hold as security for the payment of the general mortgage debt the following:

1. The promise of the Reading Company to pay, the Reading Company having become a railway company.
2. The promise of the *old* Coal Company to pay.
3. The railroad properties and equipment and other property of the Reading Company.
4. The coal properties of the *old* Coal Company.
5. The capital stock of the *old* Coal Company.

But the Reading Company must first exhaust its resources to the last dollar to pay the general mortgage bonds before the old Coal Company can be called upon by the trustee under its secondary obligation. The stock of the old Coal Company no longer belongs to the Reading Company, so it cannot use that stock in part payment of its obligation. It has no control of the coal properties and cannot use those either.

The Reading Company will hold, however, a claim against the old Coal Company for \$25,000,000 maturing on that day.

The Reading Company has promised the *new* Coal Company that it will on that day or earlier deliver to the *new* Coal Company the stock of the *old* Coal Company free from the lien of the general mortgage and, also,

that it will release from the general mortgage the coal properties of the *old* Coal Company.

Suppose the old Coal Company defaults to the Reading Company; that is to say, is unable to pay the Reading Company \$25,000,000 on January 1, 1997. If by reason of that default the Reading Company is unable to meet its obligation under the general mortgage, the trustee under the general mortgage may be obliged to sell the coal properties held thereunder, but it has been elsewhere noted that in the event of such sale by foreclosure under the general mortgage, the decree prevents and prohibits the coal properties and the railroad coming into a single control (R. 298, par. 6). Therefore, at this point, we have only to consider whether a default by the old Coal Company under the new mortgage for \$25,000,000 can, by any possibility, result in a recreation of the illegal combination. As we have noted above, the Reading Company has become merged with the Railway Company and has only the powers of a railway company. Therefore, under the laws and Constitution of Pennsylvania, it has no power to acquire the coal properties of the Coal Company at a sale under the new mortgage.

(c) The Modifications in the Plan were agreed to by the Attorney General.

Under the plan as first drawn, and filed February 14, 1921, it was proposed to obtain a release of the coal property from the lien of the general mortgage, and to discharge the Coal Company from the liability on the general mortgage bonds, provided such release and discharge could be acquired by the payment by the Reading Company to the bondholders of a premium not exceeding 10 per cent. upon the par value of the outstanding general mortgage bonds (R. 41-42, par. 4). The issuing of new refunding and improvement mortgage bonds to the Reading Company was contemplated. These were to be ex-

changed for the general mortgage bonds which should agree to the plan.

The plan which the Reading Company filed February 14, 1921, contained this statement (R. 42, par. 5) :

"It is assumed that the Attorney-General will ask the court to direct the release of the stock of the Coal Company from the lien of the general mortgage on such terms as the court may fix."

The foregoing provision of the original plan was abandoned in the modified plan.

In the modified plan, which appears at pages 274 to 277 [and which is not reprinted in the decree, although it forms part of the decree (R. 290)], it is provided merely that

"the Reading Company will agree with the Coal Company that *at or before the maturity of the general mortgage bonds*, it will obtain the release of the Coal Company's property from the lien of the general mortgage and the discharge of the Coal Company from liability on the general mortgage bonds."

Subsequently, on March 1, the United States filed a supplemental bill to make the Central Union Trust Company of New York a party to the cause (R. 48 *et seq.*). The Government alleged that the Reading Company had pledged with the Trust Company as trustee the capital stock of the Coal Company, and that the Reading Company had presented a plan for the dissolution of the combination which provided for the release of the stock of the Coal Company from the lien of the general mortgage, and, also, for the release of all the property of the Coal Company from the lien of the mortgage, and the assumption of the entire obligation thereof by the Reading Company (R. 49). The answer of the Central Union Trust Company (R. 151-152) asserts that its only interest is as trustee; that all the bonds under the mortgage were

not delivered at the time of the execution of the mortgage, but bonds have been issued and delivered up to 1920 for the purposes prescribed in the mortgage; that the bonds are numerous and widely scattered and few of the owners thereof, if any, are in any way identified with the management of the properties of the Reading Company or its auxiliaries, and that such bondholders have not been parties to any conspiracy, and that it is not necessary that the mortgage or the lien thereof should in any wise be disturbed in order to fully carry out the mandate of the Supreme Court.

Three of the intervening petitioners below are Pennsylvania corporations who own general mortgage bonds, and they intervened as such (R. 144-147).

The petition of the Insurance Companies, appellants (R. 71), objected to disturbing the lien of the general mortgage upon the coal properties and the stock of the Coal Company. It was urged that a segregation of the coal and railway properties could be effected by providing in the decree for the making of such agreements with the trustee as would render impossible any common control of the coal and railway properties. Several suggestions were made as to the form of such a decree, which will be found on pages 71 and 72.

The supplemental petition and answer of the Reading Company enumerated the three questions concerning which it desired to learn the decision of the District Court, as follows (R. 183):

"1. The question between the preferred and common stockholders.

"2 Whether the Coal Company's stock should be held free from the lien of the mortgage.

"3. Whether the Reading Company should offer a premium of 10 per cent. to the general mortgage bondholders for release of the Coal Company's property from the lien of the mortgage."

The answer said also (R. 183):

"Concerning questions '2' and '3,' the Reading Company expresses no opinion. The provisions of the plan involving the proceedings as to which these questions arise, were inserted primarily to satisfy the Government and this Honorable Court."

The Reading Company asked that if the court should determine either or both of these proceedings to be unnecessary, it might have an opportunity to present a modified plan in the light of such determination (R. 184 and 185).

Questions "2" and "3" (*supra*), enumerated in the petition of the Reading Company, were set down for argument with question "1" on May 2nd, by the order of the lower court, filed April 12, 1921 (R. 206).

Before the argument, however, the Reading Company and the Attorney-General agreed to certain modifications of the plan. Paragraph "Fourth," which as originally drawn (R. 41-42), provided that the Reading Company would obtain the release of the coal property from the lien of the general mortgage, was changed so as to read (R. 210):

"The Reading Company will agree with the Coal Company that, at or before maturity of the general mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the general mortgage, etc."

These modifications appear in the record, pages 210 to 212, and were signed as approved on behalf of the United States by Mr. Myers (R. 212).

The modifications agreed upon and filed at the same time changed Paragraph "Fifth" so as to read (R. 210):

*"If the court so orders, the Reading Company will, subject to the lien of the general mortgage, sell * * * its interest in and to the stock of the Coal Company, etc."*

(d) Important Injunctive Provisions Were Added by the Modified Plan.

The Attorney-General had agreed that it was not necessary to secure the release of the stock of the old Coal Company from the lien of the general mortgage and was content with a transfer of the entire interest that the Reading Company had in the stock of the old Coal Company, subject to the lien of the mortgage.

It should be noted, however, that most important injunctive provisions were added to paragraph "Fifth" by the modified plan. These injunctive provisions prevent the recreation of the combination.

1. It was provided that there should be embodied in the final decree "a permanent injunction against the new corporation exercising its voting power on the stock of the Coal Company in such a way as to bring about any new relations between the Coal Company and the Reading Company of the character complained of in the present suit" (R. 270).

2. A provision was inserted to protect the Government in the event of a default under the general mortgage and a sale of either (a) the stock, or (b) the coal properties of the old Coal Company. This provision reads (R. 270):

"The final decree may provide that if by reason of default on the general mortgage bonds, the trustee, the Central Union Trust Company, shall exercise the right to vote the stock of the Reading Coal Company, it shall so exercise that right as not to bring about unity of management between said Coal Company and Reading Company; and the final decree may further provide that, in the event the trustee at any time is obliged to sell the stock or properties of Reading Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests."

There was another modification as the Attorney-General agreed that the Paragraph numbered "7" of the plan might be omitted (R. 212). The omitted paragraph (R. p. 44) had provided for the execution by the Reading Company of a refunding and improvement mortgage and that bonds under such mortgage might be exchanged for bonds under the general mortgage, which latter bonds, however, were to be kept alive until the general mortgage was released.

As pointed out above, the court below had set for argument on May 2d, the three questions which the Reading Company had asked to have argued, but when the matter came on for hearing, counsel for the Reading Company and for the United States and, also, for the trustee under the general mortgage, and counsel for the three intervenors who held blocks of general mortgage bonds, stated that they had reached an agreement in respect of points "2" and "3" (R. 280). They explained to the court the modifications of the plan which they had agreed upon. The court asked that these modifications be submitted in writing. They were filed on May 12th (R. 210-212).

The modified plan appears in the record, pages 274 to 277. The paragraphs in italics on these pages are identical with the modifications of May 12th, and printed on pages 210 to 212. The complete plan is found in the decree, pages 287, *et seq.*, except that pages 274 to 277 must be added, these pages not having been reprinted in the decree in order to save space.

It will be noted that the Plan was prepared in consultation with the court below. Judge BUFFINGTON refers to this fact in his opinion (R. 278-279). He states that after the return of the mandate of the Supreme Court, the court called before it counsel for the United States and counsel for the Reading Company (R. 278), "and directed the latter in consultation with the former to for-

multate a dissolution plan in conformity with the said mandate. In accordance with these directions and after consultation by all of said counsel from time to time with the court, a tentative plan was eventually drafted and placed on file in the clerk's office for the inspection of all parties concerned. Subsequently, the court gave a hearing to all parties who desired to be heard and signified its willingness to receive for consideration petitions to intervene. Numerous parties and representatives of various interests having thus been heard, and numerous briefs having been filed showing the views of the parties concerned, the Court was thereby placed in possession of such information as enabled it to determine what parties should be allowed to intervene, and, also, to formulate such questions, issues and objections to the proposed plan as would afford a basis for an enlightened and constructive discussion on the part of all parties of record" (R. 278-279). The court enumerates the questions which it set for argument on May 2, 1921, by its order of April 12, 1921, in which order it directed that all parties who desired to be heard should file briefs on April 30, 1921, containing in substance their proposed arguments.

The court continues (R. 279):

"Having thus in advance the advantage of the proposed arguments, the Court found on the day set for argument that, due to a modification of the plan agreed to by the Attorney-General of the United States, the counsel for the Reading Company and counsel representing certain holders of bonds secured by the general mortgage of the Reading Company, substantially all of the above questions were disposed of save those arising under Subdivision 'B' of the first question."

Subdivision "B" referred to the controversy between the different classes of stockholders.

III.

The Third Question.

The third question for consideration on the re-argument is:

“Whether compliance with the decree will confer on any one class of stockholders of the Reading Company any benefit, to the prejudice of any other class of stockholders.”

In the brief filed on the first argument on behalf of Adrian Iselin and others representing preferred stockholders, we discussed the authorities at some length. This subject is also considered in the brief of the Reading Company filed on the re-argument, pages 57 to 59, inclusive.

In our former brief we pointed out:

That the distribution of the coal asset is a compulsory dissolution by the direction of the court and in liquidation of the affairs of the Reading Company;

That the charter and certificates of the Reading Company are silent as to what shall be done in the event of dissolution or liquidation, and, therefore, it follows that all classes of stock share alike;

That this is not a distribution of net profits by way of a dividend; that it is the disposition of an asset which has been owned in specie by the Reading Company since the reorganization in 1896;

That the coal asset was never earned or could be earned by the Reading Company itself, nor was it paid for out of earnings or net profits;

That the stock certificates provide that after providing out of net profits of any year for dividends on the first and second preferred stock, the directors may declare out of “surplus net profits” of such year dividends upon the common stock;

That the only words of limitation of any kind on the rights of the preferred stockholders are contained in the clause establishing dividends "at the rate of but not exceeding four per cent."

We also pointed out; that the Plan provides for the merger of the Reading Company with the Railway Company and the surrender by the Reading Company of all powers not appropriate for a railroad corporation of Pennsylvania; that the special charter of the Reading Company will be terminated; that the merged corporation will be subject, as a common carrier, to the laws of the United States and to the Constitution and laws of Pennsylvania; that under the decisions of Pennsylvania the effect of such a merger is a dissolution destroying the actual identity of both companies (Iselin brief, pp. 28-30).

In this memorandum we shall recite in some detail the history of the acquisition of the coal asset; this will make clearer the statement that the disposition of these assets is in no sense a distribution of profits by way of a dividend within the meaning of the clause contained in the stock certificates, which provides that dividends shall be paid "out of net profits."

On this subject, the court below said, Circuit Judge BUFFINGTON writing the opinion, concurred in by Circuit Judge DAVIS and District Judge THOMPSON (R. 281-282):

"From these considerations it is apparent that whatever this disposition of the stock may be called, it is in no sense an earning of the Reading Company which is to be disposed of by that company as a dividend. It is a taking by the law of an asset of that company, a stock asset, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself. Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company.

were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings.

"Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets."

Ever since the Philadelphia & Reading Railroad Company, the predecessor of the Railway Company, began to acquire coal properties, in 1870, the production, purchase and sale of coal by the Coal Company, and the transportation of coal to market by the Railroad Company, have formed inseparable parts of one business, controlled by a single interest. In the early days, prior to 1896, the Coal Company was operated by and as a department of the Railroad Company which held all the stock of the Coal Company. Prior to 1896, the general mortgage and income bonds of the Railroad Company were secured by mortgages covering the coal properties of the Coal Company as well as the railroad of the Railroad Company, and the stockholders of the Railroad Company properly regarded the coal properties as one of the assets of their company.

The reports of the Railroad Company, beginning in 1871, emphasize the importance of the coal properties. Extracts from these reports appear in the record (R.

263, *et seq.*), and some are contained in the opinion of Mr. Justice CLARKE (R. 5, *et seq.*).

The importance of the coal properties has been frequently commented upon in the reports of the directors. In the annual report for 1893 of the Railroad Company, predecessor of the Railway Company, it was stated (R. 263):

"For the last quarter of a century the maintenance of the integrity of the Reading System as a whole, and the preservation of the franchises of both the railroad and coal and iron companies so as to develop and operate the properties of both companies to advantage, have been regarded as of cardinal importance to all interested, either as creditors or as stockholders. No inventory and appraisement of separate items are of any importance, except so far as a statement of these assets may give an assurance of the permanence and growth of the income, unless it is proposed to sell the property in parcels, and such a method of realizing its value has never been seriously proposed."

The report then refers to the provision in the general mortgage of 1888 which requires the sale of the entire mortgaged property as a whole unless a majority of the bondholders direct the trustee to sell in parcels. The report continues:

"It is thus manifest that any plan for the reorganization of the affairs of the Reading Companies must be based upon the maintenance of the property as an entirety and as a going concern."

In the report of the Philadelphia & Reading Railroad Company for 1894, it was stated (R. 264):

"The management have always felt that of all branches of the business of the Reading Companies the most important and the most promising is the production and sale of anthracite. In all other departments the Reading Companies compete with rivals who are placed and equipped for business as well as or better than themselves, but

in the coal business they have a vast undeveloped estate, which needs only time, patience, and resolution to develop profitably. To this development, both in producing and marketing the coal, they have devoted their best energies."

The single and all-controlling purpose in planning the reorganization of 1896 was to preserve the union of the coal properties and the railroad in one business and under a unified control.

The Reading Company, through the old Coal Company, acquired the vast coal holdings having in 1896 an estimated value of \$95,000,000 by issuing in payment therefor and delivering en bloc \$70,000,000 par value of preferred stock, a like amount of common stock and \$50,369,000 general mortgage bonds of the Reading Company (R. 8 and 160). Those who took the preferred stock in 1896 invested their money in a company which was to carry on the business of producing, purchasing and selling coal and transporting it to market (Mr. Justice CLARKE, R. 9). The attractive feature to all who invested was the permanent union of the two industries,—coal mining and the transportation of coal. This union, they thought, would be profitable, and thirteen prominent attorneys and the Attorney-General of Pennsylvania advised them that it was lawful (R. 251-252).

Twenty-five years later it is held that the 1896 plan was and is unlawful and, by compulsion of law, the coal properties are to be severed from the railroad. The plan of disintegration provides that both classes of stockholders of the Reading Company, preferred and common, shall participate equally in the distribution of the coal assets, just as they participated equally in the acquisition of those assets in 1896 by paying like assessments. The appellants would set apart the vast coal properties for the benefit of the common to the exclusion of the preferred, on the theory that they can segregate the coal assets from the other assets, put them into a surplus, and then appropriate that part of the surplus by way of a dividend.

But by what process of reasoning can the disposition of the coal assets be described as a dividend "out of net profits"? As Judge BUFFINGTON said (R. 281):

"It is in no sense an earning of the Reading Company which is to be disposed of by that Company as a dividend."

The coal assets formed part of the original enterprise and have always been an essential part of the security behind the preferred stock. The court continued (R. 281):

"It is a taking by the law of an asset of that Company, which was and has been owned in specie by the Reading Company since the Reading reorganization was formed and which never was earned or could be earned by the Reading Company itself."

Counsel for the appellant must rest his entire case upon the words, "dividends at the rate of but not exceeding four per cent," for there is no other limitation of any kind on the rights of the preferred stockholders which does not also apply to the common. The requirement that dividends shall be paid "out of net profits" applies to the dividends on the common stock as well as on the preferred stock.

Therefore the appellant must establish that the distribution of the coal assets is a dividend. Otherwise his case falls. He may not enlarge the meaning of the clause, "dividends at the rate of but not exceeding four per cent." so as to make it include something which is not a dividend. If it had been intended to exclude the preferred stockholders from equal participation with the common in anything except dividends, either the stock certificates or the charter would have so provided. It is axiomatic that there are numerous other rights than the right to dividends. Neither the charter nor the certificate denies to the preferred stock equal participation in other rights than dividends, and, therefore, under the law of all jurisdictions the preferred are entitled to equal participation therein.

For example, the charter gives the preferred the right to subscribe to an increase in the capital stock, because it provides, "Should the capital stock be increased, the stockholders at the time of such increase shall be entitled to a pro-rata share of such increase upon the payment of the instalments thereon duly called for" (R. 194). (See our former brief p. 10). If the surplus should be paid out in the form of a stock dividend, the preferred would share equally with the common.

Another example: The charter and the certificates are silent in the event of the liquidation or dissolution of the Company. Therefore, under the law of Pennsylvania and of all other jurisdictions, the preferred stock has equal rights with the common in the assets of the Company upon liquidation.

If the stockholders of the Reading Company should refuse to take the corporate steps necessary to put into effect this or some other plan for the segregation of the coal properties, the court below will appoint receivers with instructions to bring about a condition in harmony with the law (Mandate, par. "Third" R. 37). The receivers would liquidate the assets. In such event the preferred and common would share alike.

We insist that as there is no limitation and as equality is equity, the preferred share equally with the common in all rights arising out of a distribution of the coal asset. The question of the respective rights on a distribution of other assets is not here involved and need not be considered. On this point, the lower court very pertinently said (R. 282):

"We deem it proper to say that under the facts and circumstances before us, the legal question of the dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings."

We know of no decision holding that the surplus of a corporation is a trust fund for the benefit of the common stockholders, and must be preserved for them irrespective of the vicissitudes of the business. In this case, the Reading Company carries on its books a claim against the Coal Company amounting to over \$69,0000,000, upon which the Coal Company has paid interest at various times during the past twenty years. This item is also carried on the books of the Coal Company. If the preferred stockholders should be deprived of the security of the coal assets now behind their investment, and these assets should be given over entirely to the common without any participation by the preferred, we think the preferred would be justified in insisting on a settlement of the debt before the Reading Company executes the general release to the old Coal Company contemplated in the plan.

The present funded debt of the Reading Company is \$132,756,000, and its capital stock, preferred and common, is \$140,000,000. (See balance sheets, December 31, 1920, of Reading Company, Coal Company and old Railway Company, R. 198-200.) In the face of this huge funded debt and the capital stock issue, it is obvious that a surplus of \$33,000,000 is inconsiderable.

After the plan has been carried into effect and the Reading Company merged with the Railway Company, the balance sheet will show a funded debt of \$161,841,000, an increase of almost \$30,000,000, while the capital stock will remain the same. (See consolidated balance sheet, last column, on page 200 of Record.) The surplus of the consolidated company will be \$54,115,000, but this figure is practically identical with the "additions to property through income and surplus," previously carried by the Railway Company, which is explained in the answer of the Reading Company (R. 172-173). This figure represents betterments and additions which the rules of the Interstate Commerce Commission require to be capitalized, and which, otherwise, would have been charged to expenses.

Only in the event that the Reading Company is able to realize from the disposition of the coal assets an amount equal to the figure at which it carries those assets on its books, is it correct to say that it had a surplus of \$33,996,000 at the end of 1920. It will be remembered that in April, 1920, this court had declared that the Reading Company must dispose of its coal assets. Included in the assets on the balance sheet of the Reading Company is the debt due from the Coal Company carried at \$69,357,000, and the stock of the Coal Company at a valuation of \$8,000,000. Therefore, unless the Reading Company realizes from the disposition of its coal assets their book value, \$77,357,000, it would not be accurate to say it had a surplus of \$33,996,000 at the end of 1920.

The Reading Company states in its answer (R. 162) that it is not material whether or not the debt of the Coal Company to it is a genuine debt, meaning that if the debt is cancelled, there will be a corresponding increase in the value of the capital stock of the Coal Company, which is entirely owned by the Reading Company. But the matter is material to the preferred stockholder if the preferred stockholder is excluded from participating in the value represented by the stock of the Coal Company. As pointed out above, the aggregate investment of \$77,357,000 in the coal properties consists of two assets,—first, the debt of \$69,357,000, and, second, the stock of the Coal Company. The court has directed the Reading Company to dispose of only one of these assets, namely, the stock of the Coal Company. Why should the preferred stockholder permit the value of that asset to be increased from \$8,000,000 to \$77,357,000 by a cancellation of the debt if the asset is then to be disposed of without any participation therein by the preferred stockholder? Should he not insist that the Reading Company collect its debt out of the Coal Company, or a large part of that debt, before the stock is surrendered? In that event, the surplus would be reduced according as the Reading Company received less than the entire amount of its claim.

IV.

The Fourth Question.

The fourth question for consideration on the reargument is:

“What the basis is upon which the amount and character of the payments to be made by the Coal Company and by the new Company to the Reading Company was arrived at, and what the reasons are for adopting it.”

The committee of preferred stockholders, whom we represent, we understand, did not participate in the conferences which resulted in the plan.

The balance sheet of the Coal Company at the close of 1920 shows total assets approximating \$112,000,000 (R. 198). If we deduct from the foregoing figure all liabilities shown on the balance sheet with the exception of the debt to the Reading Company, we arrive at a figure of over \$103,000,000 as the net value of the assets. But as stated, this does not take into account the debt of \$69,357,000 to the Reading Company.

Moreover, the liability of the Coal Company on the general mortgage bonds is not carried on the balance sheet, although the Coal Company is joint obligor with the Reading Company and more than \$93,000,000 of general mortgage bonds are outstanding.

The fourth question is discussed in the brief of the Reading Company, filed on this reargument, pages 44 *et seq.* (See also R. 163-164 and 167-168.)

It is therefore respectfully submitted that the decree should be affirmed.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,

Solicitors for Adrian Iselin, et al., as a committee representing certain first and second preferred stockholders, Appellees,
40 Wall Street,
New York City.

IN THE
Supreme Court of the United States,

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY
and FIDELITY-PHENIX FIRE INSUR-
ANCE COMPANY OF NEW YORK,
Appellants,

AGAINST

READING COMPANY and Others,
Appellees.

No. 609

On Reargument

SEWARD PROSSER, MORTIMER N. BUCK-
NER and JOHN H. MASON, as a Com-
mittee, etc.,

Appellants,

AGAINST

READING COMPANY and Others,
Appellees.

No. 610

BRIEF FOR CENTRAL UNION TRUST COMPANY OF
NEW YORK (HEREIN CALLED THE "MORTGAGE
TRUSTEE") TRUSTEE OF THE GENERAL MORT-
GAGE OF READING COMPANY AND THE PHILA-
DELPHIA & READING COAL & IRON COMPANY,
DATED JANUARY 5TH, 1897.

Chronology.

1890.

The Sherman Law was enacted.

1897.

This Mortgage was executed.

1913.

This action *to which the Mortgage Trustee was not a party* was begun.

1920.

The decision of this Court declaring the Combination invalid was rendered.

This court, in its opinion directed, among other things, that the cause be remanded with directions to enter a decree in conformity with its opinion, dissolving the combination of the Reading Company, The Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company, existing and maintained through the Reading Company, with such provisions *for the disposition of the shares of stock and bonds* and other property of the various companies *held by the Reading Company*, as may be necessary to establish the entire independence from that Company and from each other of the above named Companies.

February 4, 1921.

After the cause was remanded pursuant to the above direction, the Reading Company filed with the Court below a plan to carry out the decision of the Court (Record, p. 40).

This plan contained the first intimation throughout the litigation of any disturbance of the securities pledged with the Mortgage Trustee.

March 1, 1921.

The United States filed a supplemental bill to make the Mortgage Trustee a party (Record, pp. 48-51).

April 12, 1921.

The Court made such order (Record, pp. 203-205), and the Mortgage Trustee filed its answer alleging that it was not necessary to disturb the lien of the mortgage in order to carry out the mandate of the Court (Record, pp. 150-152).

June 6, 1921.

The Court made its final order which did not disturb the lien of the mortgage (Record, fols. 287-313).

June 16, 1921.

Assignments of error filed which in no wise raised any question affecting the Mortgage Trustee (Record, p. 317), and appeal allowed (Record, p. 320).

January , 1922.

Appeal argued, in which argument the Mortgage Trustee did not participate, as no question affecting it was raised by the assignments of error.

February 27, 1922.

Reargument ordered, and the Court subsequently through the clerk, stated that on the reargument special attention should be given to four stated questions, only two of which interest the Mortgage Trustee, viz.:

"1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company, and the New Company to be organized, as is required by the opinion and judgment of this Court."

"2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modifications of the decree, for sale of the Coal Company stock, owned by the Reading Company, free from the lien of that mortgage and from the lien of the contemplated new mortgage."

POINTS.**I.**

The decree of the District Court does provide for the segregation prescribed by the opinion of this court.

This point will, we assume, be argued at length by the counsel for the Reading Company, and the Solicitor General, and we will do no more than briefly point out the salient features of the plan that provided for the separation of interest in the coal property from interest in the railroad property.

- (a) The general mortgage bonds are the joint obligation of the Reading Company and the Coal Company. By the plan, the Reading Company assumes the payment of the bonds, and agrees that at or before the maturity of the mortgage it will obtain a release of the coal lands from the general mortgage (Record, pp. 274-5).
- (b) The Reading Company, *subject to the lien of the general mortgage* sells to a new company
 - (1) all its interest in the Coal Company stock;
 - (2) all its rights to vote thereon;
 - (3) all its rights to receive dividends thereon; and no dividends are to be declared on the Coal Stock, prior to the sale to the new company (p. 292).
 - (4) All the stock of the new company is to be issued to a trustee approved by the Court.

- (5) Before acquiring stock in the new company, a prospective stockholder must make affidavit that he owns no stock in the Reading Company (the so-called Southern Pacific-Union Pacific method) (293).
- (c) The new company is to submit to the jurisdiction of this Court by becoming a party to the action.
- (d) The new company to have independent management approved by the Court.
- (e) On default in the general mortgage, the Mortgage Trustee shall exercise the voting right, if it exercise it at all, so as not to bring about unity of management between the Coal Company and the Railroad Company; and if it sell the coal stock, it shall sell the same to interests different than that of the Reading Company (Record, p. 277).
- (f) Jurisdiction of the suit is retained for the purpose of giving full effect to the decree, and making such order as may be necessary to carry out its enforcement (p. 302).

All the provisions were amply safeguarded by the decree approving the plan (Record, pp. 291-302).

II.

Any modification of the decree, providing for the sale of the Coal Company's stock, free from the lien of the General Mortgage, would present both legal and practical difficulties.

A.

The Bonds Secured by the Mortgage.

There are now upwards of \$96,000,000 of these bonds outstanding.

They mature in 1997.

They bear a 4% interest rate.

According to the records of the Mortgage Trustee

about.....	\$50,000,000	were issued at or about the date of the mortgage.
about.....	36,000,000	were issued between 1897 and 1920, to take up and in exchange for underlying bonds that were liens prior to the reorganization and for the most part dated prior to the passage of the Sherman Act (Art. I, Sec. 3 of General Mortgage).
about.....	20,000,000	were issued between 1898 and 1911 for betterments (Art. I, Sec. 4 of General Mortgage).
say	\$106,000,000	
Retired by Sinking Fund, say.	10,000,000	
	<hr/>	
	\$96,000,000	

The owners of these \$96,000,000 of bonds are numerous and widely scattered, and few of them, if any, are in any way identified with the manage-

ment of the properties of the Reading Company or the Coal Company (Record, p. 152).

The answer of the Mortgage Trustee alleges that the bondholders have not, nor did they ever have, any part in the conspiracy set forth in the bill of complaint (Record, p. 152).

Many of the bonds are held by fiduciaries (Record, pp. 144-147).

B.

The Refunding Mortgage.

So far as the provisions of the mortgage relate to the pledge of the securities therein as collateral security for the payment of the bonds, they are in conventional form.

Some of its covenants, however, are particularly appropriate to the situation with which it dealt.

A perusal of the mortgage shows beyond doubt that the representation of the Reading Company to its bond purchasers was that they should at all times have as security for the payment of their bonds, both the Railroad and the Coal Company stocks.

All the stock and equipment of the Railroad is pledged (as well as all the stock of that Company), and a direct lien is given on the lands of the Coal Company, and while there is ample power given to the Trustee by the release clause to release other properties, it is expressly precluded from ever releasing either the Railroad or the Coal stock.

Until default the Reading Company has the right to vote and receive the dividends declared on the Coal Company stock.

After default these rights are in the Mortgage Trustee.

The decree of the District Court prevents the exercise of these rights in any way contrary to the decision of this Court by its provision for the payment of such dividends and voting of such stock, before default (Record, 296-7) and by its control of the Mortgage Trustee after default (Record, pp. 298, 302).

It would seem that the plan thus enables the Court to retain control of the future acts of the Reading Company for a much longer period than it could if it were to now order the sale of the Coal stock.

C.

As to the Legal Difficulties.

The authority of the Court to grant relief at the instance of the Government in cases of this description springs chiefly from Sections 1 and 4 of the Anti-Trust Act.

The material part of Section 1 of the Act is as follows:

"Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal."

Section 4 of the Act provides:

"The several Circuit Courts of the United States are hereby vested with jurisdiction to prevent and restrain violations of this Act; and it shall be the duty of the several district attorneys of the United States, in their respective districts under the direction of the Attorney General to institute proceedings in equity to prevent and restrain such violations;

such proceedings may be by way of petition setting forth the case and praying that such violations *shall be enjoined or otherwise prohibited.*" (Italics ours.)

It is to be noted that the purpose of a suit authorized by the Statute is "to prevent and restrain violations of the Act". If therefore there is no violation of the Act there is nothing to be prevented or restrained.

This Court found that the Reading Company, the Coal Company and the Railway Company were parties to an illegal conspiracy. It did not find, nor can it be found, upon the facts, that the holders of the general mortgage bonds are parties to or in any way connected with such conspiracy, hence the valid pledge for their benefit of the securities in question, to wit, the Coal Company stock is not a "contract . . . or conspiracy in restraint of trade or commerce among the several states, or with foreign nations". It follows there is no violation of the Act by the pledge and therefore in this suit this Court should not disturb the pledge.

It may be argued that because the Reading Company, the Coal Company and the Railway Company have been found by this Court to be parties to an unlawful conspiracy, therefore, the valid pledge of the stock of the Coal Company for the benefit of innocent third parties, to wit, the general mortgage bondholders, can be disturbed. This does not follow. The rule as laid down by the decisions of this Court and other Federal courts clearly recognizes that not all the acts of a party to an illegal combination are subject to the prohibition of the Act. It is only *a direct act in restraint of trade* that constitutes a violation of the Act and therefore is subject to redress. Collateral acts, *even of an illegal*

combination in restraint of trade, are not within the prohibition of the Act.

Connelly v. Union Sewer Pipe Co. (1901),
184 U. S. 540;

Wilder Mfg. Co. v. Corn Products Co.
(1914), 236 U. S. 165;

*Chicago Wall Paper Mills v. General
Paper Co.* (1906), 147 Fed. 491;

*Boatmen's Bank of St. Louis, Mo., v. Fritz-
len* (1915), 221 Fed. 145, 146.

In the *Connelly* case, the Union Sewer Pipe Company brought suit against the defendant Connelly on two negotiable promissory notes given by the defendant to the plaintiff on account of the purchase by the defendant from the plaintiff of sewer pipe. The defendant set up as a special defense to the plaintiff's cause of action "that the plaintiff was a combination in the form of a trust in restraint of trade and commerce among the several states . . . and that this action is brought solely to recover the price of articles of merchandise, to wit, sewer and drain pipes, sold to the defendant by the plaintiff then and there acting and doing business as such a combination, as aforesaid, in violation of the provisions of said Act."

The Court, in overruling this contention, said, page 550:

"But the act does not declare illegal or void any sale made by such combination, or by its agents, of property it acquired or which came into its possession for the purpose of being sold—such property not being at the time in the course of transportation from one State to another or to a foreign country. The buyer could not refuse to comply with his contract of purchase upon the ground that the seller was an illegal combination which might be re-

strained or suppressed in the mode prescribed by the act of Congress; *for Congress did not declare that a combination illegally formed under the act of 1890 should not, in the conduct of its business, become the owner of property which it might sell to whomsoever wished to buy it.* So that there is no necessary legal connection here between the sale of pipe to the defendants by the plaintiff corporation and the alleged arrangement made by it with other corporations, companies and firms. The contracts under which the pipe in question was sold were, as already said, collateral to the arrangement for the combination referred to, and this is not an action to enforce the terms of such arrangement. That combination may have been illegal, and yet the sale to the defendants was valid." (Italics ours.)

In *Chicago Wall Paper Mills v. General Paper Co.*, *supra*, the Circuit Court of Appeals for the Seventh Circuit, after pointing out that the sale of merchandise by an unlawful combination is not rendered void by the Anti-Trust Act of the State of Illinois, said, page 494:

"The same distinction has been drawn under the federal anti-trust act (*Hopkins v. United States*, 171 U. S. 578, 592, 19 Sup. Ct. 40, 43 L. Ed. 290; *Anderson v. United States*, 171 U. S. 604, 615, 19 Sup. Ct. 50, 43 L. Ed. 300), and this court has several times held that contracts founded upon a good consideration are collateral to the unlawful scheme or combination and not tainted thereby. *Dennehy v. McNulta*, 86 Fed. 825, 30 C. C. A. 422, 41 L. R. A. 609; *Star Brewery Co. v. United Breweries*, 121 Fed. 713, 58 C. C. A. 133; *Harrison v. Glucose Co.*, 116 Fed. 304, 53 C. C. A. 484, 58 L. R. A. 915."

In *Boatmen's Bank of St. Louis, Mo., v. Fritzlen*, *supra*, the question of the validity of a loan of

money was before the Circuit Court of Appeals, Eighth Circuit. The Court in holding that the defense of the Kansas Anti-Trust Act was not a bar to the cause of action of the Bank for the recovery of the money loaned, said, page 165:

"The bank parted with some \$10,000 of its money upon the agreement that that amount should be repaid and that the notes it held as collateral should likewise be paid. It was to get two benefits: The payment of its advances; the realization upon its collateral. We think that this was as an entirety a valid agreement between Fritzlen and the bank. It was not a contract to carry out restrictions in trade or commerce. It was a contract for the payment of money it had loaned, and which presumably it loaned in part because and as a result of the transaction it was getting security also to satisfy its collateral. The motive which moved the bank was a perfectly honest and proper one, and had nothing in it violative of the Anti-Trust Act."

The language of the above cases makes it clear that the pledge of the Coal Company stock by the Reading Company under the General Mortgage is a valid, legal and subsisting act. This Court, therefore, is not empowered by the Anti-Trust Act, or by any authority with which it is vested, to impair or abrogate the terms of the mortgage by compelling the release of the Coal Company stock therefrom.

D.

As to Equitable Considerations.

We have seen that about fifty per cent. of the general mortgage bonds now outstanding were issued from time to time after the execution and delivery of the general mortgage, to wit, after Jan-

uary 5, 1897, and certain of them as late as 1920. We have likewise seen that the covenant not to release stock of any corporation, all of whose stock or a majority of which was pledged under the general mortgage, assured to bondholders that the Coal Company's stock would never be released from that instrument.

Though these provisions clearly appear in the mortgage and all parties openly proceeded under the plan from the time the same was declared operative, it was not until the filing of the present bill in September, 1913, nearly seventeen years after the promulgation of the plan and over fifteen years after the date of the general mortgage, that the Government or anybody else in any way questioned the validity and legality of the scheme or gave any notice of disapproval thereof, and even then no attempt was made to disturb the general mortgage.

A very large proportion of the bonds now outstanding are reserved bonds issued pursuant to the mortgage provisions hereinbefore referred to and taken and accepted by the holders thereof upon the assurances contained in the general mortgage and upon the assumption that the Reorganization Plan was valid and legal and the property covered by the mortgage would not be disturbed. This assumption was certainly justified because the Reading Company had been allowed to proceed for many years unchallenged in carrying out the provisions of the plan and the covenants of the general mortgage. It was natural therefore that such bondholders concluded that the plan had the approval of the authorities. We, therefore, submit on behalf of such bondholders that their position should be carefully considered by the Court, and as we have shown full compliance with the provisions of the

mandate of this Court can be had without disturbing the general mortgage, such bondholders should be left with the lien for which they bargained.

There is another class of these general mortgage bondholders who are entitled to still greater consideration and that is the holders of "outstanding old bonds" (which are really underlying bonds and which hereafter will be designated as such), who exchanged the same for general mortgage bonds under the provisions of Article One, Section 3.

The general mortgage was subject to certain underlying mortgages securing underlying bonds, which mortgages were prior liens upon some, but not all, of the mortgaged and pledged properties. The general mortgage covenants in Article Two, Section 5, that these underlying bonds, when they mature, may be extended or new bonds may issue with lien prior to that of the general mortgage. It also covenants in Article One, Section 3, that the holders of such underlying bonds may, if they desire to do so, surrender the same and take general mortgage bonds instead.

Between the date of the promulgation of the plan, 1895, and the commencement of this action, 1913—at that time there being no challenge as to the legality of the scheme—many of the holders of such bonds, relying upon the covenants of the mortgage, availed themselves of the right to exchange the underlying bonds for general mortgage bonds. It follows therefore that all general mortgage bonds so issued were unquestionably issued upon the faith of the covenants of the general mortgage and in reliance upon the validity thereof and such exchanging bondholders were justified in assuming, by reason of the length of time which had elapsed during which the plan was being openly carried

out, that the mortgage was valid and its covenants would be observed. It would seem, therefore, that underlying bondholders who exchanged their bonds for general mortgage bonds during the seventeen years intervening between the promulgation of the plan and the filing of this action, by reason of the length of time which had intervened and the fact that the Government had taken no steps to question the plan, were authorized to and did assume that the plan was approved; hence, such underlying bondholders *having changed their position* in reliance upon the covenants of the general mortgage and upon the justified assumption that the scheme of control therein outlined was legal, are entitled to and should receive from a court of equity due consideration, and their rights should be protected by not disturbing the lien for which they bargained and of which they were assured at the time they made the exchange in question.

E.

As to Practical Difficulties.

While it is true that the general mortgage is one of the instrumentalities through which the plan of reorganization of 1895 was effected, and the subsequent operation of the combination resulting from that plan has been condemned as an illegal combination, nevertheless, the mere fact that the general mortgage was a portion of such plan does not necessarily make *that* instrument illegal or improper.

We submit that an analysis of the opinion of this Court and of the record upon which the same was based, and also of the present record, clearly shows no defect in the general mortgage. The Reading Company and the Coal Company had a perfect

right to pledge their property and securities for the purpose of obtaining the advances received from or of extinguishing the debts paid by, the general mortgage bonds. It is not the pledge of such securities and properties, nor the holding thereof for the benefit of the general mortgage bonds, as provided in the general mortgage, that is condemned, but it is the use by the Reading Company of the powers reserved in respect to such securities and properties over and above the rights given to the Trustee of the general mortgage and its bondholders, that has been found to be illegal, therefore, as the instrument itself and the acts done thereunder are in no wise tainted with illegality, nor are the beneficiaries under that instrument parties to the illegal conspiracy, there is no necessity of disturbing that instrument in order to cure the evils complained of.

We have seen that by the provisions of Article Sixth of the general mortgage it was covenanted that the stocks of any company of which all or a majority were pledged would not be released from such mortgage during its life. In other words, that is a promise to investors, hoping to induce them to put their money in the enterprise and upon which they have a right to rely, that their security will always be twofold, and their investment will not be at the hazard of a single enterprise. This may well have been a very potent inducement to those investing in the general mortgage bonds, and particularly so, where, as we have seen above, the right of the Reading Company to thus pledge its properties and securities was unchallenged by the United States or by any one else for many years after the plan was put in operation.

It must be borne in mind that the Reading Company has succeeded in very advantageously placing about \$96,000,000 of 4% Bonds, which will not mature until 1997, and it may be claimed that the release of the stock of the Coal Company, even if made pursuant to a decree of this Court, will be a breach of the covenants of the mortgage, by reason of which the general mortgage bondholders will have a right to insist upon the enforcement of the default provisions of the mortgage resulting in an acceleration of the maturity of the principal of the bonds and a sale of the property and securities pledged to satisfy the mortgage debt thus precipitated. Such a result would certainly be calamitous to the Reading Company. The court will take notice of the fact that it would be impossible under the present money conditions to replace this financing except at a cost of many millions of dollars, if at all.

It is submitted therefore that where the result sought to be accomplished can be legally and effectively reached without these disastrous consequences, that the course followed should be one by which this peril is avoided, and therefore the lien of the general mortgage should not be disturbed.

III.

**The lien of the general mortgage
should not be disturbed.**

Dated, April 5th, 1922.

LARKIN, RATHBONE & PERRY,
Solicitors for Central Union Trust
Company of New York, Trustee
under the General Mortgage,
80 Broadway,
New York City.

JOHN M. PERRY,
ARTHUR H. VAN BRUNT,
of Counsel.

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY AND Fidelity-Phenix Fire Insurance Com- pany of New York, appellants, v. THE UNITED STATES OF AMERICA, READ- ing Company, The Philadelphia & Reading Coal & Iron Company, et al.	}	No. 609.
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SEWARD PROSSER, MORTIMER N. BUCK- ner, and John H. Mason, as a committee representing holders of common stock of the Reading Company, appellants, v. THE UNITED STATES OF AMERICA, READ- ing Company, Philadelphia & Reading Coal & Iron Company, et al.	}	No. 610.
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*APPEALS FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE EASTERN DISTRICT OF PENNSYL-
VANIA.*

MEMORANDUM FOR THE UNITED STATES.

The appellants, holders of common stock and representatives of holders of common stock of Reading Company, challenge the right of holders of

the first and second preferred stock to participate equally with holders of common stock in certain alleged benefits resulting from the dissolution of the so-called Reading combination pursuant to the mandate of this court.

The question raised by the appeals, involving alleged conflicting rights of different classes of stockholders of Reading Company, is neither one of general public importance nor one in which the United States has a direct or special interest.

The United States, however, has a vital interest in upholding the power of district courts to work out dissolutions of corporate combinations under the antitrust act. And in particular the United States is concerned in upholding their discretion to make such disposition of the stock of any one member of such combination, held by any other, as may be necessary effectually to terminate the offending relation.

On the former appeal (253 U. S. 26) this court remanded the cause to the District Court with instructions to enter a decree in conformity with its opinion,

dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading

Company, as may be necessary to establish the entire independence from that Company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company. (Rec. 25.)

On receipt of the mandate an interlocutory decree was entered (Rec. 31) requiring defendants to file in the District Court within 90 days a plan of dissolution. The relations between the several corporate defendants were extremely intricate, and so far as the Reading group was concerned the situation was complicated by the existence of an underlying general mortgage. The problem of working out a plan which, while effectually dissolving the unlawful combination, would not unduly affect property rights innocently acquired was one of great difficulty.

In *United States v. American Tobacco Co.* (221 U. S. 106, 185) this court enumerated the controlling factors in working out a decree of dissolution under the antitrust act as follows:

1. The duty of giving complete and efficacious effect to the prohibitions of the statute;
- 2, the accomplishing of this result with as little injury as possible to the interest of the general public; and, 3, a proper regard for the vast interests of private property which may have become vested in many persons as a result of the acquisition either by way of stock ownership or otherwise of interests in the stock or securities of the combination without any guilty knowledge or intent in

any way to become actors or participants in the wrongs which we find to have inspired and dominated the combination from the beginning.

And in the *Northern Securities case* (193 U. S. 197, 360) the court said:

This, it must be remembered, is a suit in equity, instituted by authority of Congress "to prevent and restrain violations of the act," sec. 4; and the court, in virtue of a well-settled rule governing proceedings in equity, may mould its decree so as to accomplish practical results—such results as law and justice demand.

A plan was finally evolved after numerous conferences between counsel for the defendants and Government counsel and between counsel for both parties and the court. It met the views of the Attorney General in every particular save one. (Rec. 45.) Numerous petitions to intervene filed by the different classes of stockholders and the bondholders were allowed without objection. (Rec. 203.) To meet the objections of the bondholders the plan was modified so as not to disturb the security of the general mortgage, and as modified the plan was approved by the United States. (Rec. 274.)

As regards the disposition by Reading Company of the stock of Philadelphia & Reading Coal & Iron Company, the plan, after providing for the assumption by Reading Company of the entire burden of general mortgage and the cancellation of the coal company's indebtedness to it, provides that Reading

Company will sell to a new corporation to be organized its equity in such stock for the sum of \$5,600,000. The new corporation will issue to trustees 1,400,000 shares of capital stock of no par value, being one-half share for each outstanding share of Reading stock. The trustees will then issue beneficial certificates of interest representing such stock, which will be offered to Reading Company's stockholders, preferred and common, share and share alike, for \$5,600,000, or \$2 for each share of Reading stock.

The certificates of interest, which will be transferable, may be exchanged for actual shares of the new corporation upon the holders making affidavit in the prescribed form that they own no stock in Reading Company. Pending such exchange the trustees will exercise all voting rights and collect all dividends. As the certificates are exchanged the trustees will pay over to the holders all accumulated dividends. (Rec. 274, 292.) When the process is completed Reading Company, and the new company which will succeed to its interest in the coal company, will be under separate and distinct ownership, since their stocks will be held by different persons. The plan, moreover, will result in a wider distribution of the stock than if it were to be disposed of by Reading Company in a block.

Appellants objected to this feature of the plan because the preferred stockholders were permitted to participate in the purchase of the certificates of interest. Their contention was, that since the certificates were supposed to have a value in excess of

the subscription price the transaction constituted a distribution of earnings, and that, since the preferred stockholders were entitled to participate in earnings only to the extent of 4 per cent per annum and had received their allotted percentage annually in the form of dividends, either they should not participate in the benefits of the plan or a different plan should be devised.

The District Court held (273 Fed. 848; Rec. 278) that the coal company stock was a capital asset of Reading Company, owned in specie since the reorganization in 1896; that it was not and could not have been earned by Reading Company, and that, consequently, the legal question of dividend distribution between different classes of stockholders was not involved. The court, therefore, concluded:

Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying stockholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. (Rec. 282.)

The court further pointed out that the opposition to the plan represented but a small percentage of the

total stock of Reading Company; that the plan had the "silently expressed approval" of a majority of the common shareholders, and the positive approval of one block of 100,000 shares of common stock. The opinion is important in this connection as showing the principles on which the plan was worked out and the considerations which led to its approval:

And in approving such plan we note that in point of fact the equity of a common participation of all stockholders, preferred and common, has not only the approval of the Government of the United States that has no interest in the controversy, save to see that equity is done to all; of the Reading Company, which has no interest save an impartial stewardship for all its shareholders; and lastly, the silently expressed approval of substantially two-thirds of the shares held by common stockholders. This significant and impressive fact cannot but be regarded as highly persuasive of the substantial equity of this plan. Of the 1,400,000 shares of the common stock of the Reading Company, less than one-third object to it. The other two-thirds, having had the opportunity to object and failing to do so, we are warranted in treating as acquiescing in the proposed plan. Indeed, we are justified from one circumstance in concluding from the positive attitude of a hundred thousand of those shares that the remainder are not only passively acquiescing but really actively approving. This particular block of a hundred thousand shares of the common stock is represented by one man who is a trustee of an estate which owns it, and

he himself is the owner of one-half of such trust estate. He or the estate have no preferred stock whatever. He is also a director of the Reading Company and as such favored the plan. By his counsel he appeared at the hearing and strongly urged its adoption, asserting his consent to the preferred stock sharing equally with the common in the disposition of the shares of the coal company. His contention was that this equal participation by common and preferred stockholders was not only fair, legal, and equitable, but that such a proportionate division tended to the welfare of all parties concerned and indeed was a course which made the plan possible. When it is considered that the nonparticipation of the preferred stockholders in the shares of the coal company and the absorption of all the stock by the common shareholders would have benefited this particular hundred thousand shares by a large sum, this court may rest assured that the proposed plan by its equality works equity. Without entering upon a further discussion of the questions involved, we are of opinion, after careful and matured consideration, that the plan as amended should be approved, and we therefore direct the preparation of a formal decree embodying its terms. (Rec. 282-283.)

The mandate of this court directing a dissolution of the combination was general in terms and necessarily conferred on the District Court a broad discretion as to how the result should be accomplished. The requirement was not within the contemplation of the organizers of Reading Company, and there

were no provisions in the charter or by-laws with respect to the respective rights of common and preferred stockholders in such a contingency. The District Court, therefore, applied to the situation general equitable principles and "moulded its decree so as to accomplish practical results—such results as law and justice demand." The result has proven satisfactory to the vast majority of Reading stockholders, and it is submitted that the decree should not be disturbed at the instance of a small minority except for very grave reasons—certainly not on a narrow question of technical right as between different classes of stockholders.

January, 1922.

JAMES M. BECK,

Solicitor General.

GUY D. GOFF,

Assistant to the Attorney General.

ABRAM F. MYERS,

Special Assistant to the Attorney General.



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In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY AND
Fidelity-Phenix Fire Insurance Com-
pany of New York, Appellants,

v.

THE UNITED STATES OF AMERICA,
Reading Company, The Philadelphia
& Reading Coal & Iron Company,
et al.

No. 609.

SEWARD PROSSER, MORTIMER N. BUCK-
ner, and John H. Mason, as a com-
mittee representing holders of com-
mon stock of the Reading Company,
Appellants,

v.

THE UNITED STATES OF AMERICA, READ-
ing Company, Philadelphia & Read-
ing Coal & Iron Company, et al.

No. 610.

*APPEALS FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE EASTERN DISTRICT OF PENN-
SYLVANIA.*

BRIEF FOR THE UNITED STATES ON REARGUMENT.

PRELIMINARY STATEMENT.

These are appeals by certain holders of the common stock of Reading Company from a decree of dissolution and injunction entered by the United States

District Court for the Eastern District of Pennsylvania pursuant to the mandate of this court in the case of *United States v. Reading Company et al.* (253 U. S. 26). The appeals were argued and submitted on the questions raised by the assignments of error—as to the relative rights of the common and preferred stockholders in the disposition of certain assets of Reading Company under the decree—and on February 27, 1922, were restored to the docket for reargument on the question whether said final decree conforms to the mandate of this court, and the attention of the Attorney General was directed to the order of restoration.

The plan of dissolution embraced in the decree of the lower court was worked out by counsel for the Government and counsel for the defendants after long-continued negotiations and after several conferences with the judges of the District Court. (Rec. 278-279.) The four main provisions of the decree are (a) merger of Reading Company and the Philadelphia & Reading Railway Company; (b) dissociation of Reading Company and the Philadelphia & Reading Coal & Iron Company; (c) disposition of the stock of the Central Railroad Company of New Jersey; (d) dissociation of the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company. In order to approach the questions, as to which the court desires counsel to give special attention, it will be necessary to review each of these provisions, outlining the purpose thereof, the reasons

which led the Government to assent thereto, and the proceedings which have been had thereunder.

As stated, the only questions raised by the assignments of error relate to alleged conflicting rights of common and preferred stockholders, and the appeals operate as a supersedeas only as to the last step in the plan for the dissociation of Reading Company and Reading Coal Company, namely, the distribution of certain certificates of beneficial interest to common and preferred stockholders, share and share alike. (Rec. 314-325.) The remainder of the decree having been left undisturbed by the appeals, certain performances have been had thereunder, including the transfer to trustees of the interest of the Reading Company in the stock of the Jersey Central and the sale of the stock of the Lehigh & Wilkes-Barre Coal Company. The record on the present appeals was specially made up by stipulation of counsel and contains only data bearing on the questions raised by the assignments of error, so that in this brief it will be necessary to refer from time to time to the record on the former appeal (Nos. 3 and 4, October Term, 1919), which for convenience will be designated "Old Record."

DECISION AND MANDATE OF THIS COURT.

On the former appeal (253 U. S. 26, Rec. 1-26) this court held, in substance:

(1) That prior to 1896 the Philadelphia & Reading Railroad Company, through its subsidiary the Philadelphia & Reading Coal & Iron Company, acquired

more than two-thirds of the acreage of the Schuylk coal field "for the frankly avowed purpose, not the forbidden by statute, of monopolizing the production, transportation, and sale of the anthracite coal of the largest of the three sources of supply" (pp. 45, 56).

(2) That the conveyance pursuant to the reorganization scheme of 1896 of the properties formerly owned by the Philadelphia & Reading Railroad Company and the Philadelphia & Reading Coal & Iron Company to Reading Company, Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company "constituted a combination to unduly restrain interstate commerce within the meaning of the (antitrust) act" (p. 48).

(3) That the great power centered in Reading Company was twice used "for the purpose of violating in a flagrant manner the antitrust act of 1890 * * * once successfully, to suppress the building of a prospective competitive railway line, and a second time, successfully until this court condemned the 65 per cent contracts as illegal, to suppress the last prospect of competition in anthracite production and transportation" (pp. 50, 59).

(4) That the acquisition in 1901 by Reading Company of approximately 51 per cent of the capital stock of the Central Railroad Company of New Jersey, which in turn owned in excess of eleven-twelfths of the capital stock of the Lehigh & Wilkes-Barre Coal Company, "placed the holding company in a position

of dominating control not only over two great competing interstate railroad carriers but also over two great competing coal companies, engaged extensively in mining and selling anthracite coal, which must be transported to interstate markets over the controlled interstate lines of railway" (pp. 50-51, 57).

(5) In view of the intimate relations of the three Reading companies and the intermingling of their affairs the coal of the Philadelphia & Reading Coal & Iron Company was "produced under the same 'authority' that transported it over the railroad," within the meaning of the commodity clause of the act to regulate commerce, "and for violation of this commodity clause, as well as for its violation of the antitrust act, the combination between the Reading Railway Company and the Reading Coal Company must be dissolved" (pp. 61-62).

(6) That for like reasons the relation between the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company "falls within the condemnation of the commodities clause and this relation must also, for this reason, be dissolved" (p. 63).

After providing for the affirmance of the provisions of the decree of the District Court dismissing the Government's bill in certain unimportant particulars, and for the affirmance of other provisions of the decree canceling restrictive covenants in mining leases and requiring the dissolution of the combination between the Philadelphia & Reading Coal & Iron Company and the Lehigh & Wilkes-

Barre Coal Company, and for the dismissal of the bill as to the Wilmington & Northern Railroad Company and the individual defendants "without prejudice," the court made the following order with respect to "the really important defendants in the case" (pp. 63-64):

As to the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, and the Central Railroad Company of New Jersey, the decree of the District Court will be reversed and the cause remanded with directions to enter a decree in conformity with this opinion, dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies held by the Reading Company as may be necessary to establish the entire independence from that company, and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh & Wilkes-Barre Coal Company, held by the Central Railroad Company of New

Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all these now combined companies may be conducted in harmony with the law.

PROCEEDINGS IN THE DISTRICT COURT.

Upon receipt of the mandate the District Court entered an interlocutory decree, called "decree on mandate," (a) finding and adjudicating that the defendants have violated the antitrust act and the commodities clause in the particulars above set forth; (b) reversing and setting aside the final decree theretofore entered by that court save in the particulars in which it was affirmed by this court; (c) providing that within a specified time the defendants should file a plan for the dissolution of the unlawful combination in accordance with the mandate; and (d) affording injunctive relief pending entry of a final decree. (Rec. 31-39.)

At the direction of the judges of the District Court, counsel for the defendants and counsel for the Government cooperated in the working out of a plan, and the judges were kept informed of the progress made at informal conferences which were held from time to time. (Op. Rec. 278.) On February 14, 1921, defendants filed a plan which was not opposed by the Government save in one particular. (Rec. 40-45.) The Government's opposition was directed to paragraph 8 of the plan providing for the trusteeing of Reading Company's interest in the capital stock of

the Central Railroad Company of New Jersey pending the formulation by the Interstate Commerce Commission of a regrouping plan for railroads pursuant to the transportation act of 1920. (Rec. 45-46.) It was the Government's position that as the decision of this court was handed down two months after the approval of the transportation act, it was the clear intention that the dissolution of the combination should be carried out regardless of that act.

On the same day the court entered an order directing that a copy of the plan and suggestions of the Government be served on the Central Union Trust Company of New York, trustee under the general mortgage, that copies be made available to the stockholders of Reading Company, and that counsel for the Government and for the defendants would be heard on March 1, 1921. (Rec. 46-47.) Copies of the plan and suggestions were sent to all stockholders of Reading Company. (Rec. 186-189.) The plan having contemplated the release of the stock and properties of the Philadelphia & Reading Coal & Iron Company from the lien of the general mortgage, the Government filed a supplemental bill to make the Central Union Trust Company a party to the suit. (Rec. 48-49.)

By March 1 there had been organized a committee representing the common stockholders, and another representing the preferred stockholders, and those committees, together with numerous other holders of the different classes of stocks and bonds, asked leave

to intervene in the cause for the protection of their interests. At the hearing counsel for the various common stockholders opposed the plan for the alleged reason, now familiar to this court, that it conferred on the preferred stockholders rights to which they were not entitled; counsel for the trustee and for the bondholders opposed the plan because it involved the disturbing of the security of the general mortgage; while counsel for the preferred stockholders favored the plan as just and equitable.

On April 12, 1921, the court entered a further order permitting these various interests to intervene as parties defendant (Rec. 203-205); and another order setting the cause down for hearing on May 2, 1921, upon the following questions:

1. (a) Whether the sale provided for in paragraph 5 of the Reading plan is such a disposition of the interest of Reading Company in the stock of the Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (b) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.

2. Whether the stock of the coal company should be sold free from the lien of the general mortgage, or whether a sale of certificates of

interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

3. Whether the Reading Company should offer a premium of 10 per cent to the general mortgage bondholders for release of the coal company's property from the lien of the general mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause. (Rec. 205-207.)

After the filing of said orders and before May 2 a modification of the plan was proposed by defendants and assented to by the Attorney General which obviated the necessity of any impairment of the security of the general mortgage. (Rec. 210-212; 279-280.) The objections of the trustee and of the bondholders thus having been eliminated,¹ the cause was heard on the questions propounded in the first paragraph of the court's order. On May 21, 1921, the court through Circuit Judge Buffington, handed down an opinion fully sustaining the modified plan as complying with the "letter and spirit of the mandate," and directing that it be embodied in a final decree. (Rec. 278; 273 Fed. 848.) Such final decree was entered June 6, 1921. (Rec. 287; 273 Fed. 854.)

On June 11, 1921, the District Court, pursuant to sections 3 and 4 of the decree, entered an order appointing trustees to hold Reading Company's in-

¹ The bondholders, therefore, are not represented directly but only through their trustee, and their rights were not passed on by the court below.

terest in the stock of Reading Coal Company and the Central Railroad Company of New Jersey. (Rec. 313.) By indenture dated August 29, 1921, all of the Reading Company's right, title, and interest in the stock of the Jersey Central was turned over to the trustees, who have voted such stock so as to bring about a complete reorganization of the Jersey Central board, of which they are now members. It having been deemed inadvisable to proceed with the plan for the dissociation of Reading Company and Reading Coal Company because of the pendency of these appeals, the coal company trustees have not actively assumed their duties but are temporarily serving as directors of that company.

On November 17, 1921, the Central Railroad Company of New Jersey, in accordance with section 8 of the decree, sold and disposed of all stock of the Lehigh & Wilkes-Barre Coal Company owned by it. One of the minority stockholders of the Jersey Central has filed an intervening petition with the District Court asking that the sale be set aside on the ground that it was not made to the highest bidder. But this court having taken jurisdiction of the whole case it is assumed that no proceedings will be had on this petition until these appeals are disposed of.

PROVISIONS OF THE PLAN.

**Merger of Reading Company and the Philadelphia & Reading
Railway Company.**

As pointed out in the opinion of this court, the purchasers of the properties of the Philadelphia & Reading Railroad Company at the foreclosure sale in

1896 conveyed those properties to the Reading Company and the newly formed Philadelphia & Reading Railway Company, as follows:

To Reading Company: (a) All real estate, including tidewater terminals at Philadelphia and on New York Harbor, but not including rights of way, depots, and yards; (b) all locomotives and rolling stock of every description; (c) all steam colliers, vessels, and other floating equipment; and (d) shares of stock and bonds of various short-line railroads forming integral parts of the Reading system.

To Reading Railway Company: All other property formerly owned by Reading Railroad Company consisting principally of rights of way, franchises, etc.

Following the decision of this court, application was made for a modification of the decree which would permit the Reading Company to retain the stock of either the Reading Railway Company or Reading Coal Company. But to allow Reading Company with its unlimited charter powers to retain either would have been wholly inconsistent with the decision. The application, therefore, was resisted by the United States and was denied by this court. (253 U. S. 478.)

Nevertheless, in order to insure the independence of the Reading Railway Company and to enable it to discharge its function as a public carrier, it was necessary that there should be conveyed to it the railroad equipment owned by Reading Company and pledged under the general mortgage. (Old Rec. Vol. IV, pp. 1665-1669.) Merely to have

required Reading Company to dispose of the "stocks, bonds, and other property" of the railway company held by it would not have sufficed unless the equipment acquired indirectly from the old railroad company could be regarded as coming within that category. For reasons hereinafter mentioned (*infra* pp. 18-20) it was deemed advisable to handle the matter with as little disturbance to the security of the general mortgage as would be consistent with an effective dissolution of the unlawful combination.

After considering and rejecting numerous proposals it was concluded that the relationship between the Reading Company and the Reading Railway could best be terminated by their merger into a new corporation having only the powers of a common carrier. With the Reading Company divested of its interest in the Jersey Central and Reading Coal Company such merger would not offend against either the antitrust law or the commodities clause; it was expressly authorized by article 10 of the general mortgage (Old Rec. Vol. IV, pp. 1734-1737); and with the assent of the Attorney General the proposal was embodied in the plan as paragraph 6. (Rec. 276.) When carried into effect it will result (a) in effectually terminating the relationship between Reading Company as a specially chartered holding company and Reading Railway Company; (b) in the surrender to the State of Pennsylvania of Reading Company's omnibus charter; (c) in the vesting in a new railroad company of the rights of way and franchises now owned by the Reading Railway and the

rolling stock and other equipment held by Reading Company, which company (*d*) will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and (*e*) will expressly accept the provisions of Article XVII of the Pennsylvania Constitution of 1874.

Dissociation of Reading Company and Reading Coal Company

First plan.—In *United States v. Union Pacific Company* (226 U. S. 470), this court held that it would not be a sufficient compliance with the antitrust law for the Union Pacific Company, in disposing of the stock of the Southern Pacific Company, to distribute such stocks pro rata to its stockholders. Throughout the negotiations in reference to the plan the Attorney General insisted that the principle of that decision should govern in the dissolution of the present combination. The Attorney General's view was acceded to by the defendants and, accordingly, the plan provides for the disposition of the Reading Company's interest in the stock of the Reading Coal Company to persons not stockholders of the Reading Company, the method employed being similar in all substantial respects to that followed in the *Union Pacific Case* (Compare Judgments and Decrees in Antitrust cases p. 217.)

The essential provisions of the plan may be summarized as follows (Rec. 40-45):

(1) The Reading Company will assume the entire burden of the \$96,524,000 general mortgage 4 per cent bonds, which are the joint obligation of Reading Company and Reading Coal Company, and will

agree to save the coal company and its property harmless therefrom.

(2) The Reading ^{coal} Company will agree to pay to Reading ~~Coal~~ Company \$10,000,000 in cash or current assets, and \$25,000,000 in 4 per cent mortgage bonds to mature on the same date as the general mortgage, the mortgage to contain provision for the issue thereunder of additional bonds for additions, betterments, etc.

(3) General releases of all claims and liabilities as between the Reading Company and Reading Coal Company, including the claim of approximately \$70,000,000 carried on the books of Reading Company as an asset and on the books of Reading Coal Company as a liability, will be exchanged.

(4) The Reading Company will agree to obtain the release of the coal property from the lien of the general mortgage and discharge of the coal company from liability on the general mortgage bonds provided such release and discharge can be obtained by payment by the Reading Company to the bondholders of a premium not exceeding 10 per cent on the par value of the outstanding bonds.

(5) A committee to be formed in the interest of the bondholders will call for the deposit of bonds and will hold them until it has been ascertained whether a sufficient number has been or will be deposited, when such committee will either stamp the bonds as assenting to the plan and return them to the depositors or else issue in their stead Reading Company refunding and improvement bonds.

(6) The Attorney General will ask for the release of the stock of Reading Coal Company from the lien of the general mortgage. Reading Coal Company will consolidate with one of its subsidiaries or else a new company will be organized to succeed to Reading Company's interest in the coal company, and in either event the consolidated company or the new company will issue 1,400,000 ² shares of no par value stock.

(7) Assignable certificates of beneficial interest in such no par value stock will be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2.00 for each half share of the Reading stock. Such certificates may be exchanged for shares of stock when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company.

(8) If and whenever the bondholders' committee shall declare the plan of exchange effective, the Reading Company will execute a refunding and improvement mortgage, which shall constitute a direct lien upon all railroads, railroad property, equipment, etc., and all deposited general mortgage bonds will be kept alive under said refunding and improvement mortgage until the general mortgage is released.

Modification thereof.—Soon after the plan was made public on February 14, 1921, it became apparent that it would be impossible to obtain the consent of a sufficient number of the bondholders to carry the plan into effect according to its terms.

² Being 1 share for every 2 half shares of outstanding Reading stock.

The bonds are largely held in Pennsylvania, many by trust companies, insurance companies, and fiduciaries. These holders appeared to regard the coal properties as the backbone of their security; and it was apparent that a 10 per cent premium, or even a larger one, would not induce them to relinquish their lien on the stock or properties of the coal company.

Oppositions to the plan, as it affected the general mortgage, were filed by the Central Union Trust Company, trustee (Rec. 150-152); the Penn Mutual Life Insurance Company, owning \$1,000,000, par value, of bonds (Rec. 144); the Girard Avenue Title & Trust Company, owning \$15,000, par value, of bonds (Rec. 145); and the Pennsylvania Company for Insurance on Lives and Granting Annuities, owning individually and as trustee, administrator, executor, or guardian, \$2,041,000, par value, of bonds. (Rec. 146-147.) In addition, numerous other holders announced their intention not merely to refrain from depositing their bonds but to intervene in opposition to the plan.

It clearly was not practicable to refinance the \$96,524,000 of 4 per cent general mortgage bonds, which would not mature for 75 years, in the 7 per cent and 8 per cent money market, which then prevailed. The Attorney General, therefore, was confronted with these alternatives:

- (1) To insist upon the court ordering the release of the stock and properties of Reading Coal Company from the lien of the general mortgage without the

consent and over the protest of the trustee and the bondholders; or

(2) To assent to a modification of the plan which, while placing in different hands the stock control of Reading Company and Reading Coal Company and providing effective safeguards against future intercorporate relations, would leave the stock and properties of the latter pledged under the general mortgage.

The following considerations appeared to make the latter course the wiser as well as the more expedient:

(1) The attitude of the trustee and bondholders made it clear that the former course would meet with an opposition which certainly would have resulted in another appeal to this court with consequent delay in effecting a dissolution.

(2) The questions propounded by the District Court in its order dated April 12, 1921 (*supra* p. 9), appeared to indicate a feeling on the part of that court that the requirements of the mandate could be met by proper injunctive provisions without disturbing the general mortgage.³

(3) This court had handed down its decision in *United States v. Lehigh Valley Railroad Co. et al.* (254 U. S. 255), ordering the dissolution of the combination between the Lehigh Valley Railroad Company, the Lehigh Valley Coal Company, Coxe Brothers &

³ The observation of the three circuit judges of the third circuit in *United States v. E. I. du Pont de Nemours & Co.*, 188 Fed. 127, 155, to the effect that in a dissolution proceeding under the antitrust act it is unnecessary to bring in mortgage or other creditors, doubtless would have been deemed controlling.

Company (Inc.), the Delaware, Susquehanna & Schuylkill Railroad Company, and the Lehigh Valley Coal Sales Company—

with such provisions for the disposition of all shares of stock, bonds, or other evidences of indebtedness, and of all property of any character, of any one of said companies, owned or in any manner controlled by any other of them as may be necessary to establish their entire independence of and from each other.

The stock of Lehigh Valley Railroad Company's principal subsidiary—Lehigh Valley Coal Company—was pledged under the former's general consolidated mortgage of which the Girard Trust Company was trustee. This court dismissed absolutely the Government's bill as to the Girard Trust Company, from which it was inferred that this court did not deem it essential to an effective dissolution of the relations between the two companies that the stock of Lehigh Valley Coal Company should be released from the lien of the mortgage.

(4) Finally, and most important, the country at that time was in the midst of a serious financial and industrial depression accompanying the transition from the artificial stimulations of war to normal conditions of peace. The condition was regarded as critical. Grave apprehension was felt that if the Government should insist upon the disruption of the general mortgage public confidence in the restoration of prosperity might be adversely affected. It seemed the course of wisdom, therefore, to avoid the possi-

bility of contributing further to an already threatening situation if it could be done without sacrifice to the effectiveness of the dissolution. The Government was not averse to any necessary surgery, but it seemed wise not to amputate any more than was necessary to secure the great policy of the Sherman law. In this it followed the admonition of this court in the *Standard Oil* and *Tobacco* cases that innocent interests, as the present holders of the bonds in question were, should be spared unnecessary injury.

Accordingly, with the assent of the Attorney General, a modification of the plan was filed providing, in substance, as follows (Rec. 210-212):

(1) The Reading Company will agree with Reading Coal Company (a) that at or before maturity of the general mortgage bonds it will obtain the release of the coal company's property under said mortgage and (b) the discharge of the coal company from liability on such bonds.

(2) The Reading Company will transfer all its right, title, and interest in the stock of the coal company, including the present right to vote and receive dividends thereon, to a new company to be organized, and will agree to save the new corporation and said stock harmless under the general mortgage, and will further agree at or before the maturity of the general mortgage to obtain the release of the coal company's stock and the delivery thereof to the new corporation—all in consideration of the payment by the new corporation to Reading Company of the sum

of \$5,600,000 and its agreement to issue its shares as provided.

(3) The new company will issue 1,400,000 shares of no par value stock, which will be sold to the stockholders of Reading Company, preferred and common, share and share alike, for \$5,600,000, or \$2 for each half share of Reading stock.

(4) The sale will be carried out in accordance with the precedent established by the *Union Pacific Case*, by issuing to Reading stockholders, with or without the intervention of a trustee, as may be provided for in the final decree, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of Reading Company.

(5) There will be embodied in the final decree an injunction against the new corporation exercising its voting power on the stock of the coal company in such a way as to bring about any new relations between the coal company and Reading Company of the character complained of in the present suit, and all necessary steps will be taken to insure an independent board and management so that the independence of the coal company need not await the process of distributing the stock of the new company among persons not stockholders of Reading Company.

(6) The decree may provide that, if by reason of default on the general mortgage bonds the Central

Union Trust Company shall have the right to vote the stock of the Reading Coal Company, it shall exercise such right so as not to bring about unity of management between the coal company and Reading Company; and further, in the event that the trustee is at any time obliged to sell the stock or properties of the coal company, it shall dispose of the same separately from the properties of Reading Company and to different interests.

Disposition of the stock of the Central Railroad Company of New Jersey.

The Central Railroad Company occupies an advantageous position on New York Harbor and for that reason possesses a strategic value in addition to its earning value as a carrier. Because of this the Jersey Central would be a desirable acquisition for any noncompetitive connecting carrier and the Jersey Central stock doubtless could be disposed of to better advantage to such a purchaser than any other. Under the provisions of the transportation act of 1920 (ch. 91, 41 Stat. 456, 481-482) the Interstate Commerce Commission is authorized to formulate a plan for the consolidation of railroads without regard to the antitrust act. Because of this the District Court was of opinion that the Reading Company's interest in the Jersey Central could not now be sold at its reasonable value, since no other railroad could acquire such interest with any assurance that it would be allowed to retain it. (Rec. 284-286.)

Rather than subject the stock to the possible sacrifice of a forced sale to the detriment not only of Reading Company but also to the almost equal number of other shareholders of the Jersey Central, the court ordered that the actual sale of the stock be deferred in view of possible action by the commission, and that it be transferred to trustees who will vote the same so as to secure "entire independence of directors and management between Reading Company, as it shall be hereafter merged with Reading Railway Company, and the Central Railroad Company of New Jersey." The decree provides, however, that the trustees shall hold such stock subject to further order, and that "the court may on its own initiative, or upon motion of the United States or Reading Company, without waiting such action by the Interstate Commerce Commission, enter an order for the sale of such stock, if and when it shall appear that the facts require it, or the situation makes it possible." (Rec. 296.)

Dissociation of the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company.

The plan for the disposition by the Central Railroad Company of New Jersey of the stock of the Lehigh & Wilkes-Barre Coal Company provided simply that such stock should be sold to persons not stockholders of the Jersey Central, Reading Company, or Reading Coal Company, and who previous to or at the time of purchase shall qualify as purchasers by a duly executed affidavit to the

effect that they do not own stock in any of those companies. As before stated, this provision has been carried out, although there is pending in the District Court an application to set aside the sale.

SPECIFIC QUESTIONS CONSIDERED.

The court having notified counsel that upon the reargument it desired special attention to be given certain specific questions, such questions will be considered in order:

1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court.

No appeal was taken by the Government from the decree of the District Court because that decree seemed to Government counsel to provide an effectual dissolution of the unlawful combination as contemplated by the opinion of this court. As regards the dissociation of the Reading Company and the Philadelphia & Reading Coal & Iron Company the decree appeared to be adequate for the following reasons:

(1) The Reading Company will be completely divested of all its right, title, and interest in the stock of Reading Coal Company, including the right to vote such stock, the right to receive dividends thereon, and the right to receive the actual shares on discharge of the mortgage.

(2) All of Reading Company's interest in said stock will be transferred to a new company which, when the process of distribution has been completed, will have as stockholders persons who are not stockholders of Reading Company.⁴

(3) The distribution of the stock of the new company to the ultimate owners will be effected through the instrumentality of trustees appointed by the court and discharging their duties under its direction, who will exercise all voting rights and collect and retain all dividends until such stock is turned over to the duly qualified owners.

(4) The officers and directors of the new company in the first instance will be elected with the approval of the court; no officer or director of the new company may at any time be an officer or director of the Reading Company;⁵ and the new company, before receiving Reading Company's interest in the coal company stock, will enter its appearance in the cause and submit itself to the jurisdiction of the court.

(5) During the three-year period allowed for the conversion of the certificates of beneficial interest for the stock of the new company no present stockholder of the Reading Company shall be a purchaser

⁴ The method adopted is substantially the same as that employed in the Union Pacific-Southern Pacific dissolution. (Judgments and Decrees in Antitrust Cases, p. 217.) The advantages of this method over that employed in the Standard Oil and Tobacco cases are pointed out in the Annual Report of the Attorney General for 1913, pp. 7-8.

⁵ It doubtless was the intention also to provide that no stockholder of the new company may be a director of the Reading Company and *vice versa*. Probably the control which the court will continue to exert over the new company and its stockholders will prevent this (*infra*, p. 28). If not the decree can doubtless be modified with the consent of all parties to provide against such a contingency.

of stock of the new company; and the Attorney General shall have access to the stock transfer books of both companies to enforce compliance with the order.

(6) Effective upon its becoming a party defendant the new company, its officers and directors, are enjoined and restrained from exercising the voting power on the coal company stock so as to form such a combination between the coal company and the Reading Company as was adjudged unlawful by this court.

(7) The Reading Company and all persons acting for or in its interest are perpetually enjoined from acquiring, receiving, holding, voting, or in any manner acting as the owner of any shares of the new company; and the new company and all persons acting for it are enjoined from acquiring, voting, etc., any of the shares of Reading Company.

(8) The coal company is permanently enjoined from issuing to the Reading Company, and the Reading Company is enjoined from receiving any stock, bonds, or other evidences of corporate indebtedness of the coal company in addition to the \$25,000,000 of 4 per cent bonds provided for in the plan of dissolution.

It results, therefore, that all intercorporate relations between the Reading Company and the Reading Coal Company will be absolutely terminated except that (a) the capital stock and properties of the coal company will remain pledged as collateral security under the general mortgage; (b) there will be an

agreement between Reading Company and the Reading Coal Company whereby the former will undertake to save the latter harmless under the general mortgage, and (c) the Reading Company will own \$25,000,000 of the second mortgage bonds of the coal company.

The agreement of Reading Company to assume the entire burden of the general mortgage will only be binding as between it and the coal company, so that the general mortgage bondholders will retain their grip on both properties. However, these bondholders are creditors and not owners of the debtor corporations, their bonds carry no voting rights, except in the event of a default, and they exercise no control over the corporate affairs. Their voting rights in the properties do not come into existence save on default, and present and prospective earnings of Reading Company would seem to make such default a remote contingency. However, even in case of default, the decree, following the plan, provides (a) that the trustee shall vote the coal company stock so as not to bring about a recurrence of the conditions condemned in this cause; and (b), if it shall be necessary to sell the properties, then the railroad and mining properties shall be sold separately and to different interests.

In addition, the decree provides for the close supervision of the dissolution proceedings by the court and the Attorney General. Under the principle announced in a recent decision of the United States District Court for Delaware, composed of the

three circuit judges of the third circuit, the jurisdiction of the court to enter orders for giving effect to the decree will continue indefinitely. (*United States v. E. I. du Pont de Nemours & Co.*, 273 Fed. 869.) That decision involved an application for a modification of the decree in the Powder Trust case by the Hercules Powder Company, one of the corporations organized pursuant to the decree to take over a portion of the assets and properties of the du Pont Company. The court held, in effect, that the Hercules Company, organized as stated, was an instrument of the court over which it would retain a continuing jurisdiction for the purpose of making all needful orders to carry out the objects of the decree. The rule would apply to the new corporation to be formed to take over the coal company stock, and it was to that decision that Judge Buffington had reference when he said (Rec. 283-284):

In the creation of such a corporation by this court's order, we follow a general course pursued in the case of *United States v. du Pont et al.* (188 Fed. 127), and the wisdom of so doing will be seen by an examination of the opinion lately filed in that case, where the purpose of such procedure is fully explained. By the creation of this new corporation by the directions of this court and by its retention of jurisdiction to enforce this decree as therein provided, the court can, if such contingency should arise by its control of this newly formed corporation, control all of its stockholders and prevent such stock from ever being used to thwart the decree made in pursuance of the plan.

The \$25,000,000 of second mortgage bonds will be considered briefly under the fourth question.

2. Whether the general mortgage having been executed and the bonds secured by it issued as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for the sale of the coal company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage.⁶

The existing general mortgage admittedly was an essential feature of the reorganization plan of 1896 (Rec. 213-251) which, this court has held, resulted in "a combination to unduly restrain interstate commerce within the meaning of the (anti-trust) act."

As shown by the plan (Rec. 221) the general mortgage bonds were designed for issuance mainly in exchange for outstanding mortgage securities of the Philadelphia & Reading Railroad Company and for new construction, improvements, and betterments—purposes not in themselves unlawful.

However, holders of these bonds may be presumed to have received them with knowledge of the scheme under which they were issued, and although they have had no voice in the management of the Reading Company it may possibly be said of them that they are *in pari delicto*, as was said of the different classes of stockholders of the Northern

⁶ It is not understood that the stock of the coal company will be subject to the lien of the contemplated new mortgage.

in the property of another company from which it has been completely dissociated.

The payments, therefore, represent the estimated proportionate share of the coal company of the burden of the general mortgage. The property and assets of the coal company comprise approximately one-third of the assets of the two companies subject to the general mortgage. Crediting the second mortgage bonds at par, the total amount to be paid is somewhat in excess of one-third of the total amount of outstanding general mortgage; but the annual interest payments on the second mortgage bonds (\$1,000,000) will amount approximately to one-fourth of the annual interest charge on the \$96,524,000 of general mortgage bonds (\$3,860,760).

While the payments bear this relation to the burden to be assumed by Reading Company under the general mortgage, the amount and character of the payments was determined upon by the directors of Reading Company based upon an estimate of the future needs and uses of the Consolidated Reading Company and the ability of the coal company to pay, the purpose being to provide for the future successful operation of both.

April 10, 1922.

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Attorney General.

JAMES M. BECK,
Solicitor General.

GUY D. GOFF,
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No. 609.

FILED

APR 8 1922

WM. R. STANSBURY
CLERK

In the Supreme Court of the United States,

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
Appellants,

v.

READING COMPANY, *et al.,*

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN
DISTRICT OF PENNSYLVANIA.

SUPPLEMENTAL BRIEF FOR APPELLANTS ON REARGUMENT.

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Of Counsel.



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CONTINENTAL INSURANCE COMPANY
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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN
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SUPPLEMENTAL BRIEF FOR APPELLANTS ON
REARGUMENT.

Introduction.

Conceiving themselves aggrieved by the final decree entered in the Court below, the appellants prosecuted this appeal and assigned as error the matters whereby the decree injuriously affected their interests as holders of common stock.

From the order of this Court setting the case for reargument, we understand the Court desires that argu-

ment be presented upon matters other than the immediate interests of these appellants as holders of common stock, and that special attention be given on the reargument to certain specified questions.

There can of course be no doubt as to the power of the Court in this case *sua sponte* to consider questions not raised by assignments of error. The appellants complain of a final decree entered upon the mandate of this Court. The power of the Court to exercise original jurisdiction to determine upon the application of an interested party whether its mandate has been observed in a decree, purporting to be entered pursuant thereto, is established. *United States v. St. Louis Terminal*, 236 U. S. 194, 199, 200. We take it that the appellants may therefore now raise questions not specifically assigned as error (*United States v. St. Louis Terminal, supra*) and that this Court *sua sponte* may inquire as to whether its mandate has been properly performed, for the interested parties are before the Court.

The question of whether or not the decree entered below, achieves the result sought by this Court in its enforcement of the Anti-Trust Act and the Commodities Clause of the Interstate Commerce Act, so far as the public interest is involved, is a matter of primary concern to parties before this Court other than these appellants. Regarding it as an obligation to the Court to respond to its request, counsel for these appellants will endeavor to answer the inquiries that have been propounded.

We have not had the opportunity nor the facilities exhaustively to examine the facts involved in some of the matters affecting the complete dissolution of the combination in restraint of trade sought by this Court through its mandate, but subject to correction to the extent that we may not be in full possession of the facts, we beg leave to submit to the Court, this supplemental brief.

The Issues upon the Reargument.

The reargument is directed

“on the question whether the decree in the District Court * * * is in conformity with the opinion of this Court in *United States v. Reading Company*, 253 U. S. 26”.

We do not understand that the order of the Court is intended to apply to questions affecting the shares of stock of the Lehigh & Wilkes-Barre Coal Company or those of the Jersey Central.

For convenience, we shall hereinafter refer to The Philadelphia & Reading Railway Company as the Railway Company, to the Philadelphia & Reading Coal and Iron Company as the Coal Company, to the Company which, under the plan, is to acquire all the right, title and interest of the Reading Company in the stock of the Coal Company as the New Coal Company, to the stock of such New Coal Company as the stock of the New Coal Company, and to the Railway Company, the Coal Company and the Reading Company collectively as the Reading Companies.

With respect to the Reading Companies, this Court in 253 U. S. 26, held that the combination between and the practices of such Companies constituted violation of Sections 1 and 2 of the Anti-Trust Act and the Commodities Clause of the Interstate Commerce Act, and in its opinion declared that the cause be remanded to the District Court

“with directions to enter a decree in conformity with this opinion, dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company * * * existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held

by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal & Iron Company * * * to the end that the affairs of all of these now combined companies may be conducted in harmony with law" (R. 25).

Manifestly the decision of this Court did not contemplate "safeguarding one public interest by destroying another" nor the removal of "one cause of illegality in a combination by substituting another". *United States v. St. Louis Terminal*, 236 U. S. 194, 205, 206. Nor did this Court intend that a final decree be entered which would be

"repugnant to the provisions of the Act to Regulate Commerce and contrary to the exercise by the State authorities of their power * * * insofar as the jurisdiction of such authorities may have extended", (*Ibid.* 207).

And it seems clear that this Court did not intend that the final decree should confer upon any one class of stockholders of the Reading Company any benefit to the prejudice of the rights of any other class of stockholders.

The main issue upon this reargument, therefore, is whether the decree of the Court below effectively dissolves the combination held to be unlawful and whether compliance with its provisions, creates illegality in other directions or disposes of property to the prejudice of any class of stockholders.

Of the questions arising upon this main issue, this Court has directed counsel to give special attention to the following:

1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish

such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court.

2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for sale of the Coal Company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage.
3. Whether compliance with the decree will confer on any one class of stockholders of the Reading Company any benefit, to the prejudice of the rights of any other class of stockholders.
4. What the basis is upon which the amount and character of the payments to be made by the Coal Company and by the new Company to the Reading Company was arrived at, and what the reasons are for adopting it.

It would also seem necessary to inquire

- (a) Whether the retention by the Reading Company of the stock of the Reading Iron Company and the merger of the Railway Company with the Reading Company is in conformity with the opinion of this Court in *United States v. Reading Company*, 253 U. S. 26;
- (b) Whether the retention by the Reading Company of the stock of the Reading Iron Company and the merger of the Railway Company with the Reading Company creates a violation of Article 17, Section 5, of the Constitution of Pennsylvania.

Position of these Appellants on the Foregoing Issues.

Upon the foregoing issues *seriatim*, the following is our position:

1. In our opinion, the disposition by the Reading Company of the stock of the Coal Company as decreed by the District Court will not establish such entire independence between the Reading Company and the New Coal Company as is required by the opinion of this Court.

2. We concede the power of this Court to direct the sale of the stock of the Coal Company free from the lien of the General Mortgage upon terms which shall be equitable to the holders of the bonds issued under the Mortgage; but we recognize there are practical difficulties in the way of accomplishing such result.

3. Upon the grounds set forth in our main and reply briefs we contend that compliance with the decree of the District Court will confer great benefit upon the holders of preferred stock of the Reading Company to the prejudice of the rights of holders of its common stock.

We will supplement our previous briefs on this question with the consideration of some matters urged upon the oral argument in this Court.

4. Appellants had no opportunity to participate in determining what the basis is upon which the amount and character of payments to be made by the Coal Company and by the New Coal Company to the Reading Company was arrived at, and have had no clear statement of the basis. We believe the basis was arrived at by the Board of Directors of the Reading Company, which Board was and is controlled by the New York Central and Baltimore & Ohio Railroad Companies. The grounds urged in support of the basis are without merit.

5. From the facts which we have been able to gather, we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company will create a violation of the Commodities Clause.

6. From the facts which we have been able to gather we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company creates a violation of Article 17, Section 5, of the Constitution of Pennsylvania which provides:

"No incorporated company, doing the business of a common carrier shall, directly or indirectly, prosecute or engage in mining or manufacturing articles for transportation over its works; nor shall such company directly or indirectly, engage in any other business than that of common carriers, or hold or acquire lands, freehold or leasehold, directly or indirectly, except such as shall be necessary for carrying on its business; but any mining or manufacturing company may carry the products of its mines and manufactories on its railroad or canal not exceeding fifty miles in length."

I.

The disposition by the Reading Company of the stock of the Coal Company as decreed by the District Court will not establish such entire independence between the Reading Company and the Coal Company as is required by the opinion and judgment of this Court.

The Coal Company has issued and outstanding \$8,000,000 par value of capital stock. The Reading Company owns all of the capital stock of the Coal Company and pledged that stock as part of the collateral to secure the joint General Mortgage of the Reading Company and the Coal Company as a part of the reorganization of the

Reading Company in 1895 (R. 7). The stock of the Coal Company is now physically in the possession of the Central Union Trust Company as Trustee under the joint General Mortgage (R. 291). There are now issued and outstanding under the General Mortgage approximately \$96,000,000 principal amount of bonds. The bonds mature in 1997.

Paragraph 5 of the Plan provides (R. 275, 276) :

"The Reading Company will, subject to the lien of the General Mortgage sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company * * * to a new corporation to be formed with appropriate powers * * * The new corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike for \$5,600,000 or \$2.00 for each share of Reading stock * * * It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific—Southern Pacific case, by issuing to Reading stockholders, * * * assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company."

This is in substance the plan for the disposition of the stock of the Coal Company, notwithstanding certain variations as to detail appearing in the decree.* Cer-

* The plan provides that the new corporation is to issue 1,400,000 shares of stock and that "such no par value stock will be sold by the new corporation to the stockholders of the Reading Company" (R. 275). The decree provides:

The stock of the new corporation shall be issued to a trustee or trustees appointed by the Court. Such trustee or trustees shall issue certificates of interest therein as contemplated by the modified plan and as hereinafter provided. The *Reading Company shall offer such certificates of interest for subscription to its stockholders** * * * (R. 292) (Italics ours).

tificates of interest in stock of a new company (the New Coal Company) which is to acquire the stock of the Coal Company subject to the General Mortgage will be "sold" to stockholders of the Reading Company.

Paragraph 3 (f) of the decree (R. 293, 294) provides for the affidavit to be executed by a holder of such a certificate of interest in order to obtain stock in the New Coal Company.

In aid of the establishment of the independence of the Coal Company from the Reading Company the decree in paragraph 3 (i) thereof provides (R. 295) :

"During the period allowed for the conversion of the certificates of interest into stock of the new corporation, no present stockholder of the Reading Company shall be a purchaser of stock of the new corporation if still a stockholder of the Reading Company; and the Attorney-General of the United States shall have access to the stock transfer books of the Reading Company and the new corporation for the purpose of enabling him to enforce compliance by such stockholders with this provision of this decree; but nothing herein contained shall extend to holdings as broker, pledgee, trustee, agent or otherwise in a representative capacity."

When all of these steps have been taken the following will be the situation of the Coal Company and its stock:

Title to the coal properties will remain in the present Coal Company. These properties are subject to the joint General Mortgage of the Reading Company and the Coal Company and no determination has been made as to the liability of each of the companies with respect to such joint General Mortgage. The \$8,000,000 of capital stock of the Coal Company will remain pledged under the joint General Mortgage and the stock will presumably stand in the name of the Central Union Trust Company as Trustee thereunder. The New Coal Company will hold the equity

of redemption in such stock. As a holder of such equity of redemption the New Coal Company will receive from the Central Union Trust Company irrevocable proxies to vote the stock of the Coal Company (R. 291) and the New Coal Company will also be entitled to receive the dividends payable upon the stock of the Coal Company (for under the terms of the joint General Mortgage the holder of the equity of redemption in the stock of the Coal Company will be entitled to all income therefrom). The stock of the New Coal Company will be held by trustees and against such stock the trustees will issue certificates of interest to the stockholders of Reading Company and a holder of such certificate may exchange it for the stock represented thereby upon making the required affidavit. Ultimately, if the plan is consummated, the stock of the New Coal Company will be held by individuals, who, it must be assumed, should be persons other than those connected with the Reading Company when merged with the Railway Company (*United States v. Union Pacific*, 226 U. S. 470).

We do not regard the provisions of the plan, aided though they are by the provisions of the decree of the Court below, sufficient to establish entire independence between the Reading Company and the Coal Company.

There is nothing in the decree which will prevent a holder of stock of the Reading Company from disposing of his holdings in the Reading Company, then making the required affidavit and obtaining the stock of the Coal Company and thereafter immediately acquiring stock in the Reading Company.

In our petition of intervention (R. 72) we suggested that the Court

“require the Reading Company to adopt a by-law that it will register no transfers of shares of stock of the Reading Company into the names of persons who shall not make affidavit that they have not for

such period as the Court shall direct, been holders of proxies* to vote shares of stock of the Coal Company."

And in reply to the question propounded by the District Court (R. 206)

"Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful,"

we said that the proposed plan, unless modified in the manner suggested by the language just quoted, is not such a disposition of the stock of the Coal Company as constitutes a compliance with the mandate of this Court. There is no hardship upon the general investing public in preventing one from holding stock in both the Reading Company and in the Coal Company. There are sufficient opportunities for lawful investment and the restriction will work no harm to any one who is satisfied to be guided by the public policy enunciated by this Court.

It was contended in the District Court and will no doubt be contended here that the instant case is governed by the decree adopted by the District Court in the *Union Pacific* case. But the decree of the lower court in the *Union Pacific* case was never passed upon in this Court, and even if it had been, it would furnish no precedent for this case.

In *United States v. Union Pac. R. R. Co.*, 226 U. S. 470, this Court was asked to approve the dissolution of

* The Plan now provides for the right to vote the stock of the Coal Company to be vested in the New Coal Company and therefore no proxies are to be issued. The stock of this New Coal Company is the equivalent of the proxy.

the combination of the Union Pacific and the Southern Pacific, theretofore declared to be unlawful, through a sale of the stock of the Southern Pacific to the stockholders of the Union Pacific. Similar methods had been adopted in the *Northern Securities* and in the *Standard Oil Company* cases. In disapproving of the proposal submitted in the *Union Pacific* case, this Court, MR. JUSTICE DAY writing, said what is precisely pertinent here (*ibid.* 474)

“each case under the Sherman Act must stand upon its own facts, and we are unable to regard the decrees in the *Northern Securities Case* and the *Standard Oil Company Case* as precedents to be followed now, in view of the different situation presented for consideration.”

We submit this case is as different from the *Union Pacific Case* as the *Union Pacific Case* was from the *Northern Securities Case* and the *Standard Oil Company Case*.

In the *Union Pacific Case* the Union Pacific controlled only 46% of the total outstanding stock of the Southern Pacific. In this case the Reading Company controls all of the outstanding stock of the Coal Company. Safeguards which would be applicable in the *Union Pacific Case* are not sufficient here.

In the *Union Pacific Case* the fact that 68 stockholders held \$139,000,000 of stock and 300 others an additional \$59,000,000 of stock, the two groups together owning 62.8% of a total issued and outstanding stock of \$316,000,000, was conceived by this Court to distinguish the case from the *Northern Securities Case* and the *Standard Oil Company Case*.

In this case two stockholders alone, The New York Central and the Baltimore & Ohio own and control approximately 43% of the total issued and outstanding

stock of \$140,000,000 of the Reading Company.* Another stockholder owns, represents or controls 101,900 shares of stock of the Reading Company.† The financial journals report the fact that he has recently been elected to the Board of Directors of the Baltimore & Ohio. These three stockholders therefore together own or control 46.8% of the total issued and outstanding stock of the Reading Company.

In the *Union Pacific Case* the 368 stockholders who owned collectively 62.8% of the outstanding stock of the Union Pacific received certificates with respect to 20.15%‡

	No. of Shares	Par Value
* The New York Central Railroad Company owns (R. 140)		
First Preferred	121,300	\$6,065,000
Second Preferred	285,300	14,265,000
Common	197,050	9,852,500
Total	603,650	\$30,182,500
The Baltimore & Ohio Railroad Company owns (R. 142)		
First Preferred	121,300	\$6,065,000
Second Preferred	285,300	14,265,000
Common	200,050	10,002,500
Total	606,650	\$30,332,500

Together the two Railroad Companies own 1,210,300 shares of the par value of \$60,515,000, or 43.22% of the total issued and outstanding stock of the Reading Company.

† Joseph E. Widener is the owner of 1,900 shares of common stock and represents 6,700 shares of common stock standing in the name of P. A. B. Widener and 93,300 shares of common stock standing in the name of the Estate of P. A. B. Widener (R. 209).

‡ The Union Pacific owned \$126,650,000 par amount of the stock of the Southern Pacific Company or about 46% of the outstanding stock of the Southern Pacific. The decree entered by the Court approved the sale of \$38,292,400 par value of the Southern Pacific stock or 13.90% of the total issued and outstanding stock of the Southern Pacific, to the Pennsylvania Railroad Company in exchange for certain shares of stock of the Baltimore & Ohio Railroad held by the Pennsylvania Railroad Company, and directed that certificates of interest in the remaining \$88,357,600 par value stock of the Southern Pacific Company, or 32.10% of the total issued and outstanding stock of the Southern Pacific to be sold to the stockholders of the Union Pacific. Hence, the holders of 62.8% of stock of the Union Pacific received certificates of interest in only 20.15% (62.8% of 32.10%) of the stock of the Southern Pacific.

of the outstanding stock of the Southern Pacific. But in this case two stockholders alone will receive certificates of interest representing 43% of the stock of the Coal Company, and they will be in a position through the sale or other disposition of their certificates of interest *to transfer control of the Coal Company.*

The *Union Pacific Case* involved a violation of the Anti-Trust Act only. In this case, the union of the companies constitutes in addition to a violation of the Anti-Trust Act, a violation of the Commodities Clause. The attraction of the Coal Company to the Reading Company has been much greater than was the attraction of the Southern Pacific to the Union Pacific.

It must be admitted that a situation where two large stockholders of the Reading Company holding 43% of its shares will also hold a 43% interest in the stock of the New Coal Company presents a question of no little concern.

A few of the possibilities need merely be suggested. Notwithstanding the terms of paragraphs (j) and (k) of the decree (R. 295) it may well be that, until a lawsuit proves the contrary, the New York Central and Baltimore & Ohio may transfer their holdings in the Reading Company to new corporations and distribute the stock of those companies among their own stockholders, and they may then acquire the stock of the New Coal Company. Or, when organizing this new corporation they may place the stock in a voting trust and distribute voting trust certificates to their own stockholders. Or, they may decide to retain their holdings in the Reading Company, and dispose of the certificates of interest in the stock of the Coal Company to a new corporation and distribute the stock of that corporation among their own stockholders. That new corporation may then obtain the stock of the Coal Company. Effective dissolution of the combination should not be dependent upon such contingencies, the illegality of which could at earliest be deter-

mined after litigation. General injunctive provisions, at best, would seem of little more effect than the criminal provisions of the Anti-Trust Act itself.

The New York Central and the Baltimore & Ohio may not *exercise* control over both the Reading Company and the Coal Company. But they may *transfer* control over both Companies, provided the transfer of their interest in the Coal Company precedes that in the Reading Company.

Surely the *Union Pacific Case*, if it is a precedent at all, cannot be invoked here. The situation is so pregnant with possibilities that we submit future litigation will be avoided by a sale of the stock of the New Coal Company outright to independent purchasers (not stockholders of the Reading Company), under such conditions as will assure the Court that they are in fact independent, with an equal opportunity to all to submit bids for the stock upon information given freely and fairly to all prospective bidders covering the nature, the character, the extent and the value of the properties of the Coal Company.

II.

This Court is vested with plenary power to separate the coal properties from the railway properties. Wherever the General Mortgage is an obstacle to the achievement of entire independence of the Coal Company from the Reading Company or the Railway Company, this Court has power upon terms which are equitable and reasonable to compel modification of the General Mortgage. Practical difficulties, however, exist in determining and carrying out terms which are equitable and reasonable.

The joint General Mortgage of the Reading Company and the Coal Company was executed with an eye to the establishment and maintenance of common control over the Coal Company and the Railway Company. The

shares of stock of the Coal Company and the Railway Company were pledged to secure the General Mortgage. The mortgage provides (Article 2, Section 9) :

"Except subject to the lien hereof or as herein otherwise expressly provided, the Companies (1) will not sell, encumber or by any voluntary act part with their respective ownership of and title to any shares of stock of any company above enumerated in I and II of Subdivision Fifth of the granting clauses hereof, or to any shares of stock of any company which shall hereafter be pledged hereunder (if a majority of the shares of such company shall have been, or shall be, so pledged), or the equity of redemption therein or the voting power thereof;"

Among the shares of stock enumerated in I and II of Subdivision Fifth of the granting clauses of the Mortgage are,

The Philadelphia & Reading Railway Company
399,900 shares, par value \$19,995,000;
Philadelphia & Reading Coal & Iron Company,
159,900 shares par value \$7,995,000.

Article Six of the General Mortgage provides :

"Upon the written request of the Companies
* * * but subject to the conditions and limitations in this Section prescribed, and not otherwise, the Trustee, in its discretion, may release from the lien and operation of this indenture any part of the mortgaged and pledged premises, excepting * * *
(2) the shares of stock mentioned under I and II of Subdivision Fifth of said granting clauses. * * *

Under this provision the Trustee is not authorized to release the shares of stock of the Coal Company or of the Railway Company from the General Mortgage, although it may release the properties of the Coal Company which are subject to the General Mortgage.

By the provisions of Section 4 of Article Four of the General Mortgage, the Trustee is authorized to sell all

of the property subject to it, in two separate lots, the first lot to be sold as an entirety to be composed of all of the property conveyed by the Reading Company to the Trustee under the General Mortgage. This includes the stock of the Railway Company and of the Coal Company.

By Section 6 of Article Four it is provided that in the event of any sale, whether made under the power of sale granted by the General Mortgage or by virtue of judicial proceedings or of some judgment or decree of foreclosure and sale, the whole of the property should be sold as provided in Section 4 of Article Four in two separate lots, unless the holders of a majority of the bonds shall request a sale to be made in some other manner.

This Court has held that the common domination and control of the Railway Company and the Coal Company is a violation of the Anti-Trust Act and of the Commodities Clause. The Court below recognized the power vested in it to limit the provisions of the General Mortgage in such manner as would tend to prevent such domination and control.

Paragraph 6 of the decree provides (R. 298):

"If by reason of default on the General Mortgage bonds Central Union Trust Company of New York, the Trustee under the General Mortgage, shall exercise the right to vote the stock of the Coal Company, it shall so exercise that right as not to bring about unity of management between the Coal Company and the Reading Company; and in the event that said Trustee at any time is obliged to sell the stock or properties of the Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests."

No objection to this provision was made below either by the holders of bonds under the General Mortgage or the Trustee thereunder.

If, in the opinion of this Court, the entire independence of the Coal Company from the Railway Company cannot be achieved without a release of the stock of the Coal Company from the General Mortgage, we deem the Court vested with power to compel the release of the stock of the Coal Company from the General Mortgage upon terms which are equitable. The power of this Court is plenary for such purpose. All agreements in the General Mortgage providing to the contrary must yield to the Anti-Trust Act which was in force and effect when the General Mortgage was executed, and must be deemed subordinate to the power of this Court to enforce the provisions of that Act.

The exercise of such power by this Court does not involve a determination of the question whether the General Mortgage was or was not invalid because it was a part of the process of creating the combination adjudged unlawful. The questions involved in *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540; *Wilder Mfg. Co. v. Corn Products Co.*, 236 U. S. 165; *Chicago Wall Paper Mills v. General Paper Co.*, 147 Fed. 491; *Continental Wall Paper Co. v. Voight*, 212 U. S. 227, are not presented here. We assume the pledge was valid and that all of the provisions of the General Mortgage are valid, except insofar as they infringe upon the Anti-Trust Act, and every such infringing provision must yield to the power of this Court adequately to enforce such Act.

Our view derives support from the decision of the District Court for the Southern District of Ohio (WARINGTON, KNAPPEN and DENISON, Circuit Judges) made in the process of dissolving the combination of railway and coal companies adjudged a violation of the Anti-Trust Act in *United States v. Lake Shore & M. S. Railway*, 203 Fed. 295. The decision is not reported, but the case resembles the case at bar so much and the reasoning of the Court appears to us so persuasive, that we think it helpful to examine the situation there pre-

sented, in order that what was there decided may clearly appear.

In order to dissolve the unlawful combination the Court directed generally that the coal companies and the railroad companies should be separated from one another (203 Fed. 295, 319). The Hocking Valley Railway Company was one of the defendants in the case. It had been created and had acquired title to various railroad properties, in 1899, pursuant to a plan for the reorganization of the Columbus, Hocking Valley and Toledo Railroad Company (203 Fed. 301). As a part of that plan of reorganization of 1899 the Buckeye Coal & Railway Co. (hereinafter called the Buckeye Coal Company) was incorporated for the purpose of acquiring the coal properties of the Hocking Coal & Railroad Company and these properties were conveyed to the Buckeye Coal Company in consideration of the delivery to the purchasing trustees at the judicial sale of 2,495 shares of its total capital stock of 2,500 shares (*Ibid.* 302). The purchasing trustees thereupon transferred the stock of the Buckeye Coal Company to the Hocking Valley (*Ibid.* 303). The combination adjudged unlawful originated in the reorganization of 1899.

The Hocking Valley and the Buckeye Coal Company then joined in the execution of a mortgage, dated March 1, 1899 (hereinafter called the Consolidated Mortgage), providing for the issue of first mortgage bonds in the sum of \$20,000,000 and secured by the properties acquired by such Companies (*Ibid.* 303). The Hocking Valley pledged the stock of the Buckeye Coal Company with the Central Trust Company, the Trustee under the Consolidated Mortgage for the further security of the Consolidated Mortgage. Out of the proceeds of the First Mortgage Bonds, the Hocking Valley acquired also the stock and properties of the Ohio Land & Railway Company, a coal company (hereinafter called Ohio Land Company), and it pledged this stock, as also the bonds of the Ohio Land Company with the Central Trust Company

under the Consolidated Mortgage.* At the time when the question arose there were issued and outstanding under the Consolidated Mortgage approximately \$16,044,000 principal amount of Consolidated Mortgage Bonds.

On October 9, 1915, the United States filed in the dissolution suit a petition seeking to enforce the sale of the interest of the Hocking Valley in the stock of the Buckeye Coal Company and the Ohio Land Company in furtherance of the decree of the Court which required the separation of the coal companies from the railway companies.

The Central Trust Company as Trustee under the Consolidated Mortgage dated March 1, 1899, had been made a party to the suit, and it appeared, filed answer and resisted the sale of the stock of the Buckeye Coal Company and the Ohio Land Company free and clear from the lien of the Consolidated Mortgage. The Court, however, directed the sale of the stock of the Buckeye Coal Company and the Ohio Land Company, as also the bonds of the latter Company, *and directed the Central Trust Company to release all claim upon such shares of stock and bonds upon the receipt or tender of the proceeds derived from the sale of such stocks and bonds respectively.* It further provided that in every instance the proceeds of sale should be received and applied by the Trustee under and according to the terms of the Consolidated Mortgage. The memorandum opinion on the right of the Court to order such a sale free from the lien of

* What the Hocking Valley did with the stock of the Buckeye Coal Company and of the Ohio Land Company does not appear from the report of *U. S. v. Lake Shore & M. S. Ry. Co.*, 203 Fed. 295. The facts, however, appear in a decision (unreported) of the Court filed in a subsequent proceeding in that case wherein the Sunday Creek Coal Company filed a petition in the nature of an intervention in the original suit, in which it asked for relief against the Hocking Valley Railway Company with respect to the stock of the Buckeye Coal Company and of the Ohio Land Company as also the bonds of the latter company. The decision on this question is printed as Appendix A to this brief.

the Consolidated Mortgage appears to us conclusive and we set it forth in full. The Court said (unreported) :

“(3) We cannot think the insistence of the Central Trust Company well founded that it is not amenable to judicial process or order requiring the company to exercise its powers to cause release to be made of the stocks and bonds in question under conditions such as those above stated, for it seems to be conceded that it is vested with power so to act on the pledgor's request, and whatever discretion it may have in such instances is certainly not one of an unreasonable or arbitrary character. * * * We regard as clear the power of the court to compel the bonds and stocks to be sold free from the lien of the consolidated mortgage, substituting therefor in the hands of the mortgage trustee the proceeds of such sale. One who takes a mortgage upon several items of property of such character that their common ownership or operation may offend against the anti-trust law or the commodities clause, and such that the mortgage serves practically to aid in tying them together, must be deemed to hold his mortgage subject to the contingency that if the complete and final separation of one item of the mortgaged property from the remainder becomes essential to the due enforcement of either named law, the court charged with such enforcement may take control of that item, free it from the consolidating tendency of the mortgage, and substitute therefor its judicially ascertained equivalent. Otherwise the mortgage will stand as the ready means of restoring—or at least tending to restore—those conditions which the court is endeavoring to destroy. It may well be true that a railroad and a coal company under common ownership and management, are worth more as security under a mortgage than when independent, and that their effective separation does impair the mortgage security, but this cannot make the law helpless.

If the power exists to direct a sale free from lien, the conditions here found make appropriate the exercise of that power. The consolidated mortgage was given by a railroad and a coal company; it challenged

attention to those features which carried potential violation of laws already passed or which might be passed; and the value of these pledged stocks and bonds, having nothing except lands to give them value, can be determined with such substantial accuracy that there is little danger of a mistake seriously prejudicial to the mortgage. We would have no confidence that a sale of the mere equity of the Hocking in these stocks and bonds would bring more than temporary independence. The purchaser could not free them from the overwhelming mortgage nor compel its foreclosure, but the danger of foreclosure and the consequent wiping out of this equity would be constant. The influence if not the practical domination, of the railroad mortgagor upon whom the purchaser must rely to prevent foreclosure, could not be escaped."

In providing in the instant case however, for the release of the stock of the Coal Company from the General Mortgage, practical difficulties will necessarily arise. The mortgagee is entitled to his security and it may not be taken from him except on terms which are equitable. If the General Mortgage allocated some value to the stock of the Coal Company we would not apprehend any great difficulty in providing for the release of the stock and for the deposit in cash subject to the terms of the General Mortgage of a sum equal to the value of the security released. The General Mortgage, however, allocates no such value.

Article Six of the General Mortgage makes provision for the use of the proceeds of property released therefrom. It provides that such sums may be employed either

"(1) to the purchase of bonds hereby secured in the same manner as is provided in Section 12 of Article Two hereof; or (2), with the approval of the Trustee, to the purchase of other property, real or personal, which shall be conveyed in trust by the Companies to the Trustee, subject to all the trusts hereby declared. Any new property acquired by the

Companies to take the place of any property released hereunder, *ipso facto*, shall become and be subject to the lien of this indenture, as fully as if hereby specifically mortgaged, but, if requested by the Trustee, the Companies severally and respectively will convey the same to the Trustee by appropriate deeds upon the trusts and for the purposes of this indenture."

The provisions of Section 12 of Article Two just referred to, are that the Trustee may employ such funds in purchasing bonds secured by the General Mortgage in such manner as to it shall seem best and at such prices as it shall deem best but not exceeding par and accrued interest. It further provides:

"To the extent that in the opinion of the Trustee bonds hereby secured cannot be bought on the terms herein prescribed, such bonds hereby secured may be purchased in the discretion of the Trustee and with the approval of the Reading Company at higher prices than those above fixed, or such unapplied balance shall be invested in securities in which Savings Banks at such time shall be authorized under the laws of New York to invest their funds, such securities to be held by the Trustee as a part of the trust estate hereunder; and the Trustee is hereby authorized from time to time in its discretion and with the consent of the Reading Company to dispose of any such securities purchased by the Trustee, and to reinvest the proceeds of such sale in similar manner, or to apply the same to the purchase and cancellation as aforesaid of bonds hereby secured.

All bonds hereby secured, when so purchased by the Trustee, shall be cancelled."

We therefore may be permitted to suggest various dispositions which we trust may be regarded as equitable to the holders of bonds issued under the General Mortgage:

(1) The stock of the Coal Company shall be sold free and clear of the General Mortgage, and the proceeds of

sale shall be deposited under the General Mortgage and subjected to the provisions of Article Six thereof with respect to the proceeds of released property. This will enable the proceeds to be employed by the Railroad Company for improvements on its property and private as well as the public interest will be benefited by the investment of such funds in additional railroad property which will thus become subject to the lien of the General Mortgage. This will practically enable the Railroad Company to obtain funds by paying interest at the rate of 4% per annum, whereas it would be compelled to pay higher rates of interest if it undertook any financing at this time. Or, to the extent that the needs of the Railroad Company do not exhaust the proceeds of sale, General Mortgage bonds may be purchased in the open market and cancelled. The bonds can now be purchased at or about 85 and the decree should contain such provisions as would enable the purchase of such bonds in the open market without duly enhancing the market price.

(2) This Court may compel the release of the Coal Company and its properties from all liability under the General Mortgage upon payment to the Trustee of \$10,000,000 in cash or current assets and the execution and delivery by the Coal Company of \$25,000,000 4% General Mortgage bonds to be secured by an appropriate mortgage. The Court may also compel the release of the stock of the Coal Company from the General Mortgage, and the sale of such stock in the manner suggested in (1).

(3) This Court may permit the payment by the Coal Company to the Reading Company of \$10,000,000 in cash or current assets and the delivery by the Coal Com-

pany to the Reading Company of \$25,000,000 new 4% Mortgage Bonds. The mortgage to secure such bonds, however, should under appropriate supervision by the Court, contain no provisions which will permit of the exercise of control by the Reading Company over the affairs of the Coal Company.* This Court may then compel the sale of the stock of the Coal Company free and clear of the General Mortgage in the manner suggested in (1).

(4) This Court may compel the release of the Coal Company and its properties from all liability under the General Mortgage and the sale of the stock of the Coal Company free and clear of the General Mortgage upon deposit with the Trustee under the General Mortgage of the proceeds of sale which shall be subject to the provisions of Article Six thereof with respect to the proceeds of released property.

In connection with any of the foregoing suggestions, this Court would undoubtedly make such provisions as it found necessary to secure the independence of the Coal Company from the Railway Company and the Reading Company, including the limitations suggested in I.

* It may be noted that the plan does not now adequately provide against agreements in such mortgage to prevent the exercise in the future of control over the Coal Company by the Reading Company. The plan provides:

"The mortgage under which they are to be issued may contain provision for the issue thereunder of additional bonds to provide for additions, betterments and improvements to a limited amount, *to be determined by the Reading Company and the Coal Company* prior to the creation of the mortgage, and shall contain provision for a proper sinking fund for the retirement of bonds issued thereunder."

III.

Compliance with the decree of the District Court will confer upon the holders of preferred stock great benefit to the prejudice of the rights of the holders of common stock.

In support of this contention we rely upon the matters set forth in our main and reply briefs. The oral argument merely strengthens the conviction that compliance with the decree of the District Court will work unwarranted injury to the rights of the common stock. If there were a *real* sale of the stock of the Coal Company for a *proper* consideration the common stock would not be prejudiced, even though a reduction in the surplus of the Reading Company might be involved.

The oral argument of appellees confirmed our contention that no sale is intended. The form of the sale is supported on the ground, among others, that it tends to work out a dissolution or liquidation. It is difficult however to appreciate why stockholders should be called upon to pay *any* consideration for their corporate property when distributed to them upon dissolution.

Supplementing our main and reply briefs we desire to refer to some of the suggestions made in oral argument by the appellees.

1. As to the right to redeem the preferred stock at par.

For the first time in these proceedings and for the first time in the history of the Reading Company, so far as we are advised, a doubt was sought to be cast on the oral argument upon the right of the Reading Company to redeem its preferred stock. The right to redeem the preferred stock, in our opinion, and as heretofore contended by us, has a bearing upon the dividend rights and the

rights upon dissolution of both the preferred and the common stock and limits the preferred stock to a realization of an amount no greater than its par value.

The following colloquy took place on the oral argument (Steno. Min. p. 84) :

"MR. JUSTICE CLARKE: What do you say as to the right to redeem the preferred stock?

Mr. White: I think that has no bearing upon the question. In the first place, it is a mere option. I will read that clause; it is a rather peculiar one; I am reading from page 26 of my brief.

'The Reading Company shall have the right at any time to redeem either or both classes of its preferred stock, at par in cash, if such redemption shall then be allowed by law.'

Nobody knows exactly why they put that in in that way; but presumably because at the time the stock was issued there was no statute of Pennsylvania which authorized this Company, or any similar company, to redeem its preferred stock.

There has been no statute since which applies to the Reading Company. There is a serious question whether it could redeem the stock, if it tried to do so."

No cloud should be permitted to be thrown upon the right of the Reading Company and of the common stock to *redeem* the preferred stock under the powers conferred in the resolutions authorizing the issuance of the preferred stock and by the provisions of the stock certificates. The right to redeem, unquestioned for a period of more than 25 years, created by the provisions of the reorganization agreement and the resolutions authorizing the preferred stock and the stock certificates, is one of the basic rights of the Reading Company and of the common stock, and we therefore submit what we think establishes that which hitherto had been supposed to be the unquestioned validity of the right to redeem the preferred stock.

a. *The right to redeem exists but an unlawful exercise thereof is prohibited.*

Counsel for Kurtz appears to base his contention upon the language "if such redemption shall then be allowed by law". He would appear to contend that the proper interpretation of that language is that the right to redeem shall not exist unless there shall have been adopted a statute in Pennsylvania, applicable to the Reading Company, with respect to such redemption. Even as thus stated in its extreme form, the argument is without merit, because as we shall show there is in Pennsylvania at this time a statute, entirely applicable to the Reading Company, which provides for the redemption of preferred stock.

But in our view, the language "if such redemption shall then be allowed by law" did not refer to any statutory authorization of the right to redeem. It was intended solely for the purpose of placing limitations upon the right to redeem so that it might not be exercised to the prejudice of stockholders or creditors of the Reading Company. It was inserted through commendable foresight exercised by the counsel who prepared the stock certificates and the resolutions creating the stock. The language is apt for that purpose. It is "allowed", not "authorized". It is allowed "by law," not "by statute". Statutes contain but a part of the law. Action is allowed by law when it is lawful either under the common law, the decisions of the courts or legislative enactments and the decisions of the courts construing them.

We need but examine the state of the law in 1896 on the question of the redemption of stock by a corporation to gather that that language was inserted in the stock certificate and in the resolution creating the preferred and common stock of the Reading Company to prevent an unlawful exercise of the right to redeem.

The purpose underlying its insertion was the same as that which prompted the Legislature of Pennsylvania

when by Act of April 28, 1873 (P. L. 1873, p. 79), it authorized corporations organized under general law to redeem preferred stock, to limit the exercise of such right by the proviso:

"that no injustice shall thereby be done to the existing rights of other stockholders or creditors of the company." *

b. *The Reading Company has the right to repurchase its own stock subject to limitations.*

To redeem preferred stock is to purchase the stock back. In *Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133, where the right to redeem preferred stock was in question, the court said:

"'To redeem', it is said in *Miller v. Ratterman*, *supra* (47 Ohio St., 141, 24 N. E. 496), 'is to purchase back; to regain as mortgaged property by paying what is due; to receive back by paying the obligation.'"

What then, was the power of a Pennsylvania corporation to purchase its own stock in 1896? The answer to this inquiry furnishes the key to the purport of the language "if such redemption shall then be allowed by law".

The power of a corporation to purchase its own stock has developed gradually until it is now generally recognized, but it is subject to the limitation that the power may not be exercised when it injures either the stockholders or creditors of a corporation.

In *Commissioners v. Thayer*, 4 Otto 631, 24 L. Ed. 133, this Court said:

"Unless prohibited by law, an incorporation may become the holder of a portion of its own shares". *Bank v. Bruce*, 17 N. Y. 507".

* The statute is set forth in full, *infra*, p. 39.

In England, it is held that a corporation cannot purchase shares of its own stock unless it is by its charter expressly authorized so to do, whether the purpose be to reissue or to retire the shares. *Trevor v. Whitworth*, 12 App. Cas. 409; *In re London, H. & C. Exch. Bank*, 5 Ch. App. 444; *Hope v. International Financial Society*, 4 Ch. Div. 327. This appears also to be the rule in California,¹ Kansas,² Maryland,³ Missouri,⁴ New Hampshire,⁵ Ohio,⁶ Tennessee⁷ and Washington.⁸

But in most jurisdictions in the United States and in this Court the doctrine that a corporation cannot purchase and hold its own stock unless expressly authorized so to do, is not recognized. *Fletcher Ency. of Corp. Sec.*

¹ *Bank v. Wickersham*, 99 Cal. 655; *Vercoutere v. The Golden State Land Co.*, 116 Cal. 410; *Schulte v. Boulevard Gardens Land Co.*, 164 Cal. 464.

² *Savings Bank v. Wulfekuhler*, 19 Kans. 60; *Abeles v. Cochran*, 22 Kans. 405; *Bank v. Strachan*, 89 Kans. 577; *Steele v. Telephone Assoc.*, 95 Kans. 580.

³ *Maryland Trust Co. v. Mechanics Bank*, 102 Md. 608; *Burke v. Smith*, 111 Md. 624; *Schaun v. Brandt*, 116 Md. 560, and *Bear Creek Lumber Co. v. Bank*, 120 Md. 566. Recent legislative enactments permit a Maryland corporation to purchase shares of its capital stock out of surplus.

⁴ *St. Louis Mfg. Co. v. Hilbert*, 24 Mo. App. 338; *Eggman v. Blanke*, 40 Mo. App. 318; *St. Louis Rawhide Co. v. Hill*, 72 Mo. App. 142; *Wilson v. Mercantile Co.*, 167 Mo. App. 305.

⁵ *Currier v. Lebanon State Co.*, 56 N. H. 262; *Latulippe v. New England Investment Co.*, 77 N. H. 31.

⁶ *Taylor v. Miami Exporting Co.*, 6 Ohio, 176; *State of Ohio v. Franklin Bank of Columbus*, 10 Ohio, 91; *Sanderson v. Iron & Nail Co.*, 34 Ohio St. 442; *State v. Building Assoc.*, 35 Ohio St., 258; *Coppin v. Greenless & Ransom Co.*, 38 Ohio St. 275. Since the repeal of the Constitutional provision for double liability of stockholders of Ohio corporations, the majority rule may become established there. *Morgan v. Lewis*, 46 Ohio St. 1; *Siders v. The Concrete Co.*, 13 O. C. C. (N. S.) 481; *Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133.

⁷ *Cartright v. Dickinson*, 88 Tenn. 476; *Herring v. Ruskin Co-operative Assoc.*, 52 S. W. 327.

⁸ *Kom v. Cody Detective Agency*, 50 L. R. A., N. S. 1073; *Barto v. Nic*, 15 Washington, 563; *Tait v. Pigott*, 32 Washington, 344; 33 Washington, 59.

tion 1136; 1 *Cook on Corporations*, 7th Ed. Section 311. The exercise of the right, however, is subject to the limitation that it must be without prejudice to the rights of stockholders and of creditors.

That the assets of a corporation constitute a trust fund for the benefit of creditors is elementary. Purchase by a corporation of its own stock constitutes a reduction of the capital assets which are subject to the claim of creditors. In many jurisdictions it is now held that a corporation may purchase its own stock only when it has a surplus sufficient in amount to enable it to purchase the shares of stock without impairing the capital stock. In other jurisdictions a surplus is not required, but stockholders may not have a preference over creditors and the ability of a corporation to pay its creditors must not be impaired by such purchase.

We set forth herewith in Appendix B, the decisions in the leading jurisdictions in this country which amply sustain the propositions herein set forth.

When the stock of the Reading Company was created the right of a corporation in Pennsylvania to acquire its own stock had been settled. Limitations had been imposed on the exercise of the right but the boundaries of the limitations were not clearly defined. In *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74, the right of a corporation to purchase its own stock was recognized in the lower Court. Stowe, A. J., said:

"I am of the opinion that a corporation, under its general corporate powers, may purchase its own stock, when the act is done in good faith for the benefit of the corporation."

On appeal, counsel for the plaintiff contended that the purchase by the corporation of its own stock was *ultra vires*, but the court denied the plaintiff, a stockholder in the corporation, the right to question the transaction after

it had been consummated. Of the right of a corporation to purchase its own stock, Woodward, *C. J.*, said:

"The employment of corporate funds to speculate in the stock of the company to which the funds belong, is not a practice to be encouraged; but the present plaintiff is not in position to censure the practice."

In *Columbia Bank's Estate*, 147 Pa. 422 (1892), the Supreme Court of Pennsylvania held that an *insolvent* corporation could not purchase its own stock. In that case the Bank issued certificates of deposit in consideration of the sale to it of shares of its stock. The Court found that the corporation was insolvent at the time and that the vendor of the stock either had or was chargeable with notice of such insolvency. The Court denied the certificates of deposit issued in consideration of the sale of the stock the right to participate upon distribution in insolvency proceedings in the assets of the Bank. With respect to the right of the corporation to purchase its own stock, the Court said:

"It is well settled in England that a purchase by a corporation of its own stock is *ultra vires*, unless the power to purchase it is clearly conferred by its charter. In our country the decisions on this point are conflicting, but they are practically unanimous in holding that an insolvent corporation cannot buy its own shares to the detriment of its creditors. As its capital stock is a trust fund for the payment of its debts, the use of this fund in the purchase of shares, in itself, is destructive, of a security intended primarily for the creditors, and a plain misappropriation of it. If the corporation was permitted so to use the trust fund, it might in this way distribute its capital among its shareholders, extinguish their personal liability and leave its creditors without security or remedy. We cannot concede that it has a power which would make such results practicable."

But in *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. 370 (decided in April, 1895), the Supreme Court of Pennsylvania affirmed the right of a corporation to purchase its own stock. The Court approved the Master's report which is set forth in the decision in full. The report said:

"A corporation has the right to acquire stock of its own, where the transaction is not prohibited by statute, is *bona fide et sine malo ingenio*. *State Bk. v. For*, 3 Blat. C. C. Rep. 431; *Bank v. Bruce*, 17 N. Y. (Ct. of App.) 507; *Coleman v. Oil Co.* 51 Pa. 74, and *Clapp v. Peterson*, 104 Ill. Rep. 26. No statute prohibitory of such dealing is known in Pennsylvania, and no right of creditors or of others than the shareholders has appeared in this case, and as to the latter nothing contrary to good faith."

The decisions clearly imported a limitation upon the right of a corporation to acquire its own stock and a prudent lawyer drafting a provision giving a corporation the right to repurchase its stock, would not have disregarded the contemporaneous decisions which declared such a limitation. A provision for the right to purchase back, stock of the corporation without limitation might have been subject to a defense of *ultra vires* on the ground that the provision properly interpreted gave the corporation the right to purchase its stock notwithstanding that the exercise of such a right might be detrimental to its creditors or stockholders.

The wisdom of the draughtsmen in providing that the right of redemption shall be exercised only if it is allowed by law at the time when the exercise of the right is sought, is demonstrated by the subsequent decisions in Pennsylvania and elsewhere (see Appendix B). In Pennsylvania, it is now clearly the law that a corporation may not purchase its own stock if creditors or stockholders are injured thereby. *Warren v. Queen & Co.*, 240 Pa. 154; *Wolf v. Excelgior A. S. & S. Co.*, 270 Pa. 547, (1921).

The Reading Company may at this time repurchase

the preferred stock. Its assets are such that its creditors would not be injured thereby.

c. The right to issue preferred stock implies the right to redeem it, but the right to redeem is subject to limitations.

Even if we regard the right to redeem as a right independent of the right of a corporation to purchase its own stock and not subject to the limitations of the right to purchase, full scope and effect is given to the language "if such redemption shall then be allowed by law".

Where a corporation is authorized to issue preferred stock it has implied power to attach a provision for its redemption, *Fletcher Ency. of Corp.*, Section 3644; *Coggeshall v. Georgia Land & Inv. Co.*, 14 Ga. App. 637; *Abrahams v. Medlicott*, 86 Kans. 106; *1 Cook on Corp.*, 7th Ed., Section 270; *Hoffman v. Penn. Warehousing & Safe Dep. Co.*, 1 Pa. C. C. R. 598 (1886); *Hackett v. Northern Pac. R. R. Co.*, 36 N. Y. Misc. 583, 73 N. Y. Supp. 1087.

In *Hackett v. Northern Pac. R. R. Co.*, 36 N. Y. Misc. 583, the preferred stockholders sought to resist the redemption of preferred stock by the Northern Pacific Railway Company. The corporation was authorized by its charter to issue preferred stock but there was no restriction or limitation placed upon it as to the terms and conditions upon which such stock was to be issued except that the Company might at its option make it convertible into common stock.

The certificate of preferred stock contained the following clause:

"The company shall have the right at its option, and in such manner as it shall determine, to retire the preferred stock in whole or in part, at par, from time to time upon any first day of January prior to 1917."

With respect to the right of redemption, JUDGE SCOTT said (at p. 587) :

“Preferred stock, in its very nature, is stock which is held under a different contract and subject to different conditions, from those under which common stock is held. It is, of course, competent for the Legislature to prescribe what these conditions shall be and to forbid all others. It may, however, leave the determination of that question to the company itself, and it does so leave it when it fails to specify and limit the conditions. The Legislature of Wisconsin placed no limitation upon the terms which this Company might attach to its issue of preferred stock, and, therefore, left it to determine those terms for itself.”

The right of redemption which was considered in *Hackett v. Northern Pacific R. R. Co.*, *supra*, was again sustained by the Circuit Court of Appeals of the Eighth Circuit in *Weidenfeld v. Northern Pac. R. R. Co.*, 129 Fed. 305.

In *Hoffman v. Pennsylvania Warehousing & Safe Dep. Co.*, 1 Pa. C. C. R. 598 (1886), it had been held that where the directors of a corporation are authorized to increase the capital stock of the company and to borrow money on bond and mortgage they may issue preferred stock, preference being given only to the extent of legal interest if earned, the stock to be redeemable out of the net earnings only.

But it is not lawful for a corporation to redeem its preferred stock by appropriation of the assets of the company which are necessary to pay creditors. *Ellsworth v. Lyons*, 188 Fed. 55. The rights of preferred stockholders are subordinate to the rights of creditors, and the assets of the corporation cannot lawfully be used to redeem the stock until corporate debts have been paid

or provided for. *Westerfield-Bonte Co. v. Burnett*, 176 Ky. 188; 195 S. W. 477.

It has also been held that a provision for the redemption of preferred stock which permits the preferred stockholders to receive the assets of the corporation in preference to creditors is contrary to public policy and void. *Spencer v. Smith*, 201 Fed. 647. Such is clearly the law of Pennsylvania. *Warren v. Queen & Co.*, 240 Pa. 154.

That a corporation could not redeem preferred stock to the detriment of its creditors and stockholders was intimated in 1879 by the Supreme Court of Pennsylvania in *Culver v. Reno Real Estate Co.*, 91 Pa. 367. A stockholder brought suit for the redemption of preferred stock basing his right upon a provision contained in the stock certificate. The court said:

"No argument or authority is required to prove the gross injustice to creditors and stockholders that must inevitably ensue, if preferred stock is allowed to take all the money from the treasury, and thereby cripple or break down the business of the corporation."
* * * The statute authorizes no such thing."

d. The language "if such redemption shall then be allowed by law" was added to prevent unlawful exercise of the right of redemption.

In order to prevent any interpretation of the right of redemption as being contrary to public policy, it was therefore prudent in 1895 to include language which would prevent the exercise of the right to the detriment of stockholders and creditors. *Spencer v. Smith*, 201 Fed. 647. For that purpose the language "if such redemption shall then be allowed by law" is apt.

e. If a statute applicable to the Reading Company authorizing redemption of preferred stock is necessary, such a statute exists.

Counsel for Kurtz stated with respect to the redemption provision (Steno. Min. p. 84) :

"Nobody knows exactly why they put it in that way, but presumably because at the time the stock was issued there was no statute of Pennsylvania which authorized this Company or any similar company to redeem its preferred stock. There has been no statute since which applies to the Reading Company."

We understand this argument to mean that the contract requires that at the time when redemption of the preferred stock is sought there be in existence a statute applicable to the Reading Company, permitting the redemption of preferred stock. But we are of opinion that such a Statute exists.

The Reading Company was incorporated under the name of Excelsior Enterprise Company by special act. The act, approved May 24, 1871 (P. L. 1871, p. 1089) gave it the rights which had theretofore been conferred upon the Pennsylvania Company under an act approved April 7, 1870 (P. L. 1870, pp. 1025-1028), and the supplement thereto approved February 18, 1871 (P. L. 1871, p. 92).

The Pennsylvania Constitution of 1857 which was in effect at the time when the special act incorporating the Reading Company was adopted, provided in Section 26, Article 1 thereof, as follows:

"The Legislature shall have the power to alter, revoke or annul, any charter of incorporation hereafter conferred by or under any special or general law whenever, in their opinion, it may be injurious to the citizens of the commonwealth; in such manner however, that no injustice shall be done to the corporators."

This provision was perpetuated by Section 10 of Article 16 of the Constitution of Pennsylvania, of 1874, which provides:

"The general assembly shall have the power to alter, revoke or annul any charter of incorporation now existing, and revocable at the adoption of this constitution, or any that may hereafter be created, whenever, in their opinion it may be injurious to the citizens of this Commonwealth, in such manner, however, that no injustice shall be done to the corporators."

The charter of the Reading Company was therefore subject to the right of the Legislature to alter, revoke or annul the same, subject to the conditions in the constitutional provisions set forth.

The supplement to the act approved February 18, 1871, creating the Pennsylvania company and which applies likewise to the Reading Company, provided:

"That the capital stock of said company as authorized by said Act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said Company may from time to time determine; and the said company are hereby authorized and empowered to issue said stock, or any portion thereof, in payment of any debt or liability incurred in the purchase of any property, or they may sell or dispose of any portion of said common or preferred stock, on such terms and conditions as the company may agree upon with any party or parties, company or companies, or in the doing of any other act authorized by the provisions of the act to which this is a supplement."

The provisions just quoted authorized the issuance of the preferred stock of the Reading Company. By an Act of the Legislature of the State of Pennsylvania entitled "An Act to authorize corporations to issue pre-

ferred stock, approved April 3, 1872 (1872 P. L. 37), provided:

"That it shall be lawful for any company now or hereafter incorporated, *by or under any general law of this Commonwealth*, to issue with the consent of a majority in interest of its stockholders, preferred stock of the company, not exceeding at any time one-half of the capital stock of the corporation; the holders of which preferred stock shall be entitled to receive such dividends thereon, not exceeding twelve per cent per annum, as the board of directors of said company may prescribe, payable out of the net earnings of the company; and the holders of said preferred stock shall not be liable for any debts of the company." (Italics ours.)

By a further act of the Legislature entitled "A Supplement to an Act entitled 'An Act to authorize Corporations to issue Preferred Stock', approved the 3rd day of April, Anno Domini 1872", approved April 28, 1873 (Pa. L. 1873, p. 79), it was provided:

"That any company authorized by the act to which this is a supplement, to issue preferred stock, may issue the same in different classes, to be distinguished in such manner as the directors of such company may prescribe; and they may give to the various classes such order of preference in the payment of, dividends, or in the rate of dividends thereon or in the redemption of the principal thereof, as may be approved by the holders of a majority of the stock of the Company; and the *company shall have the right to redeem its preferred stock* upon such terms as may be prescribed in the issue thereof; and it may specifically appropriate for the payment of the dividends upon any class of stock, or for the redemption of the principal thereof; the revenues from any specific department of its business or the proceeds of any specified portions of its assets or property: *provided, That no injustice shall thereby be done to the existing rights of other stockholders or creditors of the company.*" (Italics ours.)

Neither the Act of April 3, 1872, nor the act of April 28, 1873, applied to the Reading Company because the Reading Company was organized under a special law and not under *any general law of the Commonwealth of Pennsylvania*.

Until a comparatively recent period, the great majority of Pennsylvania corporations were formed under the provisions of special acts. These special acts not only provided for the incorporation of the corporations to which they related respectively, but defined their powers, prescribed regulations for their government and defined their relations with the public. The body of statute corporation law of Pennsylvania was therefore for many years contained in these special acts. *1 Eastman, Private Corporations of Pennsylvania*, 4.

The Constitution of Pennsylvania of 1874 forever destroyed the power of the Legislature to thereafter create corporations by special laws. Section 7 of Article 3 of the Constitution provides (Purdon's Digest, 13th Ed. Vol. I, p. 152) :

"The General Assembly shall not pass any local or special law * * *

(25) creating corporations or amending, renewing or extending the charters thereof."

Immediately upon the enactment of the Constitution of 1874, the Corporation Act of April 29, 1874 (P. L. 1874, p. 73, *et seq.*), which provided a uniform system for the formation of such corporations as might then be formed, was enacted.

The Act of April 29, 1874, made provision for the acceptance thereof by any corporation organized for any of the purposes named and covered by the provisions of the Act or in existence under the provisions of any general law of Pennsylvania, and upon such acceptance such corporations would acquire the rights conferred upon

corporations by the Act of April 29, 1874. Section 16 of the Act of April 29, 1874, provided:

"Every corporation created under the provisions of this act or accepting its provisions, may, with the consent of a majority in interest of its stockholders, obtained at a meeting to be called for that purpose, of which public notice shall be given during thirty (30) days in a newspaper of the proper county, issue preferred stock of the corporation, the holders of which preferred stock shall be entitled to receive such dividends thereon as the board of directors of the corporation may prescribe, payable only out of the net earnings of the corporation."

It has been held that corporations organized under the Act of April 29, 1874, acquired the rights conferred by the Act of April 3, 1872, and the Act of April 28, 1873, upon corporations organized under a general law. *Warren v. Queen & Co.*, 240 Pa. 154 (1913). The provisions for the redemption of the preferred stock contained in the Act of April 28, 1873, are applicable to preferred stock issued under the provisions of Section 16 of the Act of 1874. *Warren v. Queen & Co.*, *supra*.

The provisions of the Act of 1873 with respect to the redemption of preferred stock and the provisions of the Act of 1874 to which they were applicable remained in effect until the adoption of the statute of May 28, 1913, which broadened the scope of the Act of 1873 and in effect extended its provisions to a corporation organized either under the *general* or the *special* laws of the State of Pennsylvania. It applied both to corporations theretofore organized as well as corporations thereafter organized in the same manner as did the statute of 1873, and it therefore comprehended corporations which, like the Reading Company, were created by special act. It repealed all other statutory provisions covering the subject matter, leaving the Act of May 28, 1913, to embody all of the statutory law then in effect on the subject of the redemption of preferred stock.

Section 1 of the Act of May 28, 1913 (P. L. 1913, p. 378), provided as follows:

"Section 1. Every corporation heretofore or hereafter incorporated *under the laws of this Commonwealth*, * * * may,—at the time of its incorporation, by provisions inserted in the certificate of incorporation, or at any later time with the consent of a majority in interest of its stockholders, obtained at a meeting to be called for that purpose, of which public notice shall have been given during sixty (60) days in a newspaper of the proper county, which county shall be that in which the principal office of the corporation in this Commonwealth shall be located,—issue preferred stock of such corporation. Said preferred stock may be issued in one or more classes, in such amounts for each class, without regard to the amount of any other class or the amount of common stock, and with such designations, rights, privileges, limitations, preferences, and voting powers, or prohibitions, restrictions, or qualifications of the voting and other rights and powers, *and upon such terms as to redemption of any class thereof*, at not less than par, or for its conversion into any other class of stock, common or preferred, as may be set forth in the original certificate of incorporation, or as may be approved and adopted by the corporation at the time of the authorization and issuing thereof. The rate of preferred dividend for any class of stock shall not exceed ten (10) percentum per annum. Such preferred stock may be issued for cash or property, or through the conversion of common stock, or through all or more than one of said methods." (Italics ours.)

Section 4 of the Act of May 28, 1913, which contains the repealing clauses clearly shows that the Act was intended to apply to corporations which, like the Reading Company, were organized under special act. It provides:

"Section 4. The following acts of Assembly, and parts of acts; namely,—‘An act to authorize corporations to issue preferred stock’, approved the

3rd day of April, Anno Domini 1872 (Pamph. Laws 37) ;

A supplement to an act, entitled 'An act to authorize corporations to issue preferred stock', approved the 3rd day of April, Anno Domini 1872', which supplement was approved the 28th day of April Anno Domini 1873 (Pamp. Laws 79) ;

Section 16 and Clause 1 of Section 39 of an act, entitled 'An act to provide for the incorporation and regulation of certain corporations' approved the 29th day of April, Anno Domini 1874 (Pamp. Laws, 73),—and all other acts and parts of acts *general or special*, inconsistent herewith be and the same are hereby repealed."

Hence, even if we were to assume that the language "if such redemption shall then be allowed by law" requires that there be in existence a statute authorizing the redemption of preferred stock, such a statute exists; it applies to the Reading Company and whatever doubt may have ever existed as to the ability of the Reading Company to exercise the right of redemption is therefore removed.

In 1915 the Act of May 28, 1913 was amended but its purport and substance remained unchanged. In 1921 (P. L. 1921, 1159 *et seq.*) an Act of the Pennsylvania Legislature repealed all of the Act of May 28, 1913 except the repealing provisions thereof (Section 4 hereinabove set forth) and substituted in place of the acts repealed provisions similar in character and substance with additional provisions. The statute enacted in 1921 is even more pointedly directed to a company like the Reading Company than the act of May 28, 1913. The Act of 1921 provides:

"Section 1. Be it enacted, &c., That every corporation, heretofore or hereafter incorporated under the laws of this Commonwealth * * * may create two or more kinds of common stock and two or more kinds of preferred stock at the time of its incor-

poration by provisions inserted in the certificate of incorporation, or, at any later time, with the consent of a majority in interest of its stockholders having voting power obtained at a meeting to be called for that purpose. Notice of the time, place and purpose of such meeting shall be published, once a week for sixty (60) days prior to said meeting, in a newspaper of general circulation and in the legal journal, if any, of the county in which the principal office of the corporation in this Commonwealth is located. Such classes of stock may, from time to time, be authorized and issued out of the unissued stock of the corporation. Such stock may be issued in one or more classes, in such amounts for each class, without regard to the amount of any other class or the amount of unqualified common stock, and with such designations, rights, privileges, limitations, preferences, and voting powers, or prohibitions, restrictions, or qualifications of the voting and other rights and powers, *and upon such terms as to redemption in any class thereof at not less than par, and convertible or not into any other class of stock, common or preferred, as may be set forth in the original certificate of incorporation, or as may be approved and adopted by the stockholders at the time of the authorization or at any time prior to the issuance thereof.* The rate of preferred dividend for any class of stock shall not exceed ten per centum (10%) per annum. Such stock may be issued for cash or property, or in exchange for other stock of the corporation, or through all or more than one of said methods; and the stock so exchanged for such preferred stock and returned to the corporation may be issued again by the corporation.

* * * * *

Section 3. The rights, privileges, and terms and conditions of any class of stock, issued and outstanding as above provided, shall not thereafter be subject to alteration or change without the consent of all the holders of such class of stock, except as may be otherwise provided by the certificate of incorporation or by the resolutions authorizing the issue of the same." (Italics ours.)

We have demonstrated the validity of the right to redeem the preferred stock solely because that right, in our opinion, bears upon the dividend rights and the rights upon dissolution of both the preferred and the common stock and limits the preferred stock to a realization of no more than its par value.

2. The question as to whether the preferred stock is entitled to a preference out of accumulated surplus is not involved here, and in any event the contention that it is so entitled is without merit.

Upon the oral argument, it was contended that the common stock is not prejudiced by carrying out the decree below because the preferred stock is entitled to a preference out of accumulated earnings. In the Kurtz brief, it was contended that common stock is prohibited from receiving dividends except from earnings of a preceding year, but that in case in any one such year there are no earnings, or earnings insufficient to pay the preferred stock its full dividends, the preferred stock may be paid dividends for such year out of accumulated surplus. It was therefore contended that the present accumulated surplus should not be devoted solely to the paying of dividends on the common stock.

The common stockholders' contention is not that surplus accumulated in any year in which the full 4% preferred dividend is not paid to the preferred stockholders should be available for the common stockholders, but that surplus accumulated in any year in which and after full 4% dividends were paid to the preferred stockholders should go exclusively to the common stockholders. Since 1903, the preferred stockholders have received their full 4% dividends (R. 58). That portion of the present accumulated surplus of the Reading Company which was

accumulated prior to 1903 is in these proceedings negligible.*

The argument of the preferred stockholders is that although the preferred has received its full 4% dividends since 1903, nevertheless, out of the surplus accumulated since 1903, the preferred is still entitled to participation because, they say, there may come a year in the future wherein the earnings will be insufficient to pay full dividends on the preferred stock, and in such case, the surplus accumulated since 1903 would be available for dividends upon the preferred stock.

Whatever may be the legal rights arising upon such a possible future contingency, that contingency is not at hand. The surplus is, at the present moment, about to be distributed. The preferred stockholders received their full 4% dividends last year, and are receiving them this year and no one has intimated that they will not receive them next year. The common stockholders' position is that their legal rights to the benefits now proposed to be distributed by way of interests or "rights" in the stock of the New Coal Company are the same as if an equivalent amount of cash received upon a sale of the coal property to the public were being distributed. The common stockholders contend that in the actual situation which is at hand, since the preferred stockholders have received their full 4% dividends, they are excluded from any participation in a distribution out of the accumulated surplus which has arisen since 1903.

* The largest amount of the accumulated surplus of the Reading Company which can possibly be claimed to have been earnings of years in which full dividends were not paid upon the First Preferred and Second Preferred Stock is \$2,263,159.56 which represents the accumulated surplus of the Reading Company on June 30, 1903 (R. 259). It is probable that the amount is less, depending upon whether or not the dividends on the Preferred Stock for the year 1903 were paid out of earnings for the year ending June 30, 1903, or the earnings of the year ending June 30, 1902. If paid out of the net earnings of the year ending June 30, 1902, the accumulated surplus for years in which full dividends upon preferred and common were not paid is \$1,239,911.71 (R. 259).

We have, we believe, demonstrated that if the coal properties or stock of the Coal Company were sold, and the resulting proceeds placed in the treasury of the Reading Company, there can be no question that such proceeds must go exclusively to the common stockholders, if they were now to be distributed to stockholders.

Therefore, even though the preferred stockholders were entitled to a preference out of accumulated surplus when current earnings were insufficient to pay their dividends (and we contend that they are not so entitled) no such question arises on the facts before the Court.

We contend, however, that the holders of preferred stock are not entitled to a preference out of accumulated surplus even as to years in which current earnings are not sufficient to pay full dividends on preferred stock.

Every presumption is opposed to the right of the preferred stockholders to a preference of 4% per annum out of accumulated earnings. No dividends have ever been paid them out of accumulated earnings, notwithstanding the fact there have been years in which current earnings were *insufficient* to pay them their dividends and there existed at that time an accumulated surplus (R. 259).

The contention that the preferred stock is entitled to a preference out of accumulated surplus arises from a failure to read the stock certificate as a whole. Severance of the first three sentences from the body of the certificate of First Preferred Stock (Exhibit C, R. 88, 89) is necessary, and without such severance the argument can scarcely be advanced (see Kurtz Brief, pp. 30, 31). When we read the certificate as a whole it appears that the preferred dividends out of the net profits of any particular year are the "*full*" dividends. The whole history of the preferred stock establishes that it was issued as a translation of the rights of creditors under Income Bonds into preferred stock (R. 221, 222, and see our Reply Brief,

pp. 16, 17). The preferred stock was issued in the main to previous creditors who were holders of Income Bonds in the old Company (R. 221, 222). As such they were entitled to interest out of the earnings of a particular year only. If the earnings of that year were insufficient to pay the interest, it was lost forever.

It is unquestioned in this case that the common stock is entitled to all earnings in particular years in excess of the amount required to pay dividends to the preferred stock for such particular years, and that the preferred stock has no right to share in such excess earnings for such particular years. The preferred stock is not cumulative. It is difficult to conceive why earnings to which the common stock is exclusively entitled, should, because they were not declared as dividends in the particular years when earned, revert to the preferred stock as a back log for the payment of dividends not earned in any one year, and deprive the common stock forever of all right in them.

3. The argument that the common stock is excluded from participation in accumulated surplus because of the language "excluding undivided net profits remaining from previous years" is without foundation.

Argument is made in the Kurtz Brief that the common stock is entitled to dividends only out of the business of a particular fiscal year and that because of the language "excluding undivided net profits remaining from previous years" the common stock is excluded from participation in the accumulated surplus.

If the words, "excluding undivided net profits remaining from previous years" be entirely omitted from the clause "if from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, * * * there shall remain net profits"

the meaning of that clause would not be affected or changed in any way or to the slightest degree. The net profits remaining from previous years are no part of the business of the current fiscal year nor are the undivided profits of previous years derived from the business of the "particular fiscal year" in question. Reading the certificate as a whole it would appear that the language "excluding undivided net profits remaining from previous years" was inserted to meet the objection probably interposed at the time when the certificate was drafted, that the provision—

"But no dividends shall in any year be paid upon any such stock" (i. e., common) "out of the net earnings of any previous fiscal year in which full dividends shall not have been paid on the First and Second Preferred Stock"

was not completely safeguarded without some such language in the previous sentence. The language "excluding undivided net profits remaining from previous years" is really surplusage, inserted out of abundance of caution.

If it had not been intended that the common stock should be paid dividends out of the surplus net profits of any particular fiscal year after payment of the dividends upon the preferred stock whenever such payment should be declared (whether in the next succeeding or any succeeding year), there would have been no reason whatsoever for the provision "but no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year *in which the full dividends shall not have been paid on the First and Second Preferred Stock.*" The exclusion of the common stock from net profits of a fiscal year in which full dividends shall not have been paid on the preferred stock, is the equivalent of authorization, if authorization were

necessary, for participation of the common stock in the earnings of any previous year remaining after payment of "full" dividends upon the preferred stock, whenever dividends from such earnings of any previous year should be declared.

No analysis or refinement of language can diminish the binding force of the undisputed facts in the Record that preferred stock has never been paid more than 4% per annum, and common stock has received more than 4% per annum for a decade without objection. There can be no possible question from the practical interpretation of the parties, that after the preferred stock received its 4% dividend out of the profits of any particular fiscal year, it was entitled to nothing further.

The argument of the Kurtz brief, if sound, would result in that so long as 4% is paid on the preferred stock, neither common nor preferred stock, are entitled to any dividends out of accumulated surplus; the common stock would *never* receive any dividends out of accumulated surplus, the preferred stock *only* when current earnings were insufficient to pay the 4% dividend on the preferred stock. To achieve any such unusual and remarkable result, express language would be necessary. If the accumulated surplus was to be a perpetual guaranty fund for the payment of the dividend on the preferred stock, it would have been easy to say so and it would have been said.

IV.

Appellants had no opportunity to participate in determining what the basis is upon which the amount and character of payments to be made by the Coal Company and by the New Company to the Reading Company was arrived at, and have had no clear statement of the basis. The basis was arrived at by the Board of Directors of the Reading Company which Board is and was controlled by the New York Central and the Baltimore & Ohio Railroad Companies. The grounds urged in support of the basis are without merit.

The plan provides for the payment by the Coal Company to the Reading Company of \$10,000,000 in cash or current assets; this was probably required because the original plan provided for the payment of such amount to the bondholders for the release of the stock of the Coal Company from the General Mortgage. Such payment is and was in our opinion unnecessary (R. 70, 71) and would be unnecessary even though the stock is released from the General Mortgage (*supra*, pp. 23-25). Under the provisions of the plan, the Coal Company is to deliver to the Reading Company \$25,000,000 new 4% Mortgage Bonds. It is probable that these \$25,000,000 of bonds with the \$10,000,000 in cash or current assets represent what, in the opinion of the board of directors of the Reading Company from whom the original plan emanated, the Coal Company should pay for a release of its property from the General Mortgage.

The plan also provides for the payment (Par. 5 of the Plan, R. 275) :

"by the new corporation to the Reading Company of the sum of \$5,600,000 and its agreement to issue its

shares to the stockholders of the Reading Company"
 * * * "The new Corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the New Corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for \$5,600,000 or \$2.00 for each share of Reading stock."

In effect, therefore, the New Coal Company was to pay to the Reading Company an amount equal to \$4.00 for each share of its capital stock (1,400,000 shares) and the New Coal Company would receive that amount from the stockholders of the Reading Company.

We have been unable to obtain any clear statement as to the basis upon which the price of \$4.00 per share for the stock of the Coal Company was arrived at. The answer of the Reading Company stated (R. 163) :

"This consideration is less than it is hoped would prove to be the intrinsic value of the coal property. It is, however, a substantial, not a nominal, consideration and is in the judgment of the board of directors of the Reading Company adequate for the requirements of the Reading Company."

We believe we have demonstrated that the stock of the Coal Company is being sold for an amount much less than its value, and in this counsel for the appellees would appear to concur. Counsel for the Reading Company upon oral argument stated :

"Now there never has been any thought in the minds of counsel of the Reading Company that the selling price of the certificates of interest was as great as their value. There has never been any doubt in the minds of the Reading Company or in the minds of the Reading board nor was there any doubt in the mind of the District Court that the right to subscribe for those certificates of interest is a valuable right" (Steno. Min. of Argument, pp. 53, 54).

Counsel for Joseph E. Widener frankly stated that the stock was worth more than \$4.00 per share. The colloquy was as follows:

"Now, this new company gets the coal property, and this new company pays \$5,600,000 into the Reading treasury for the coal property.

MR. JUSTICE McREYNOLDS: How much is it worth—that coal property?

Mr. Ballard: It is worth more than that.

MR. JUSTICE McREYNOLDS: How much?

Mr. Ballard: It is worth, perhaps, \$30,000,000 or \$40,000,000 more than that. You asked that question of Mr. Cook; he gave you several tests. One was the——

MR. JUSTICE McREYNOLDS (Interposing): Just give me your own view of it.

Mr. Ballard: My view is this: That this property during the past five years, which your Honor said were abnormal years, earned an average of \$4,400,000. If you capitalize that at 7 per cent, which is a fair way to arrive at a value, as I think we will agree, you get a valuation of this property of \$60,000,000—call it \$4,200,000, and divide it by 7.

If you capitalize it at 6 per cent, you get a valuation of \$70,000,000.

Now, of that \$60,000,000 or \$70,000,000, \$40,000,000 goes back into the treasury of the new Reading Company—\$10,000,000 in cash; \$25,000,000 in bonds, and \$5,600,000 for what is, perhaps, an inadequate consideration.

Now, your Honor also asked Mr. Cook——

MR. JUSTICE McREYNOLDS (Interposing): Well, I would like to know what you estimate as the value of the thing which is going to be sold for \$5,600,000?

Mr. Ballard: I estimate the value of that thing at from \$60,000,000 to \$70,000,000, less the \$35,000,000 that is taken out. I estimate the value of that thing at from \$35,000,000 to \$40,000,000.

MR. JUSTICE McREYNOLDS: All right" (Steno. Min. pp. 65, 66).

Counsel for Kurtz said:

"The complaint which is made here by the appellants to the effect that the preferred stock ought not to share in what they refer to as the 'distribution' of the coal stock, *which does give them something of value, I think, over and above what they pay for it*—their contention is based entirely on the proposition that the surplus of the Reading Company is the property of the common stockholder" (Steno. Min. p. 71). (Italics ours.)

Counsel for the Iselin Committee stated:

"Now it has been said and it may be taken for the purposes of this argument—and it must be taken—that the stock has a greater value than \$2 per share; precisely what, is a matter of speculation" (Steno. Min. p. 95).

There could be no question that \$4 per share did not represent the value of the coal stock in the face of the earnings of the Coal Company, the book value of the stock and the vast extent of its properties, as set forth in III of our main brief.

It would appear that \$4 per share for the stock of the Coal Company is now supported on a variety of grounds; by one appellee it is supported as a payment upon dissolution or action analogous to dissolution of the corporation; by another, as a payment by the stockholders upon a compulsory segregation of assets; by another, because it is necessary to get the vote of the preferred stockholders to support the plan;* by another of the appellees on the ground that the holders of pre-

* Counsel for Joseph E. Widener states (Steno. Min. p. 68):

"The Plan here is a plan suggested by the Reading Company, and accepted by the court. We say that, if this satisfies the mandate of the Court, we will do this thing; and in order to do this thing, we must get the vote of the stockholders. You can only get a majority vote of these stockholders, if the preferred stock gets something out of it; for the preferred stock actually can deadlock this company, and practically controls it, because the larger holdings are in the hands of a few—"

ferred stock are entitled at least to an equal share in accumulated surplus and by some of the appellees upon the theory that equity is equality and upon a combination of all of these grounds. It is difficult to perceive why a sale should be supported on any other ground than that it constitutes a disposition of property for its value. We have demonstrated that neither of the grounds now urged by the appellees will support the sale.

We have endeavored to determine the reason which moved the Board of Directors to propose a sale of the stock of the New Coal Company at \$4 per share and we have been able to conclude merely that that basis was urged because if the sale was valid as a sale, no inquiry would be necessary into the relative rights of preferred and common stockholders, and no further inquiry would be involved as to whether what was being done was a disposition of property or the declaration of a dividend.

V.

From the facts which we have been able to gather, we are forced to conclude that the retention by the Reading Company, when merged with the Railway Company, of the stock of the Reading Iron Company will be in violation of the Commodities Clause.

This Court in its opinion and mandate entered thereon directed the District Court to enter a decree dissolving the combination of the Reading Company and the Coal Company and the Railway Company—

“with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that Company and from each other of the Philadel-

phia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company * * * to the end that the affairs of all of these now combined companies may be conducted in harmony with the law."

The decree of the lower Court does not make the Railway Company independent of the Reading Company. It provides instead (Par. 6 of the Plan, R. 276) :

"The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage."

We do not believe that this Court by the language of its decree intended to preclude the merger of the Reading Company with the Railway Company. But such merger is not to be permitted if it brings about a result different from that which would be brought about (so far as the conduct of the affairs of these companies in harmony with the law is affected) if the Reading Company were to be separated from the Railway Company.

Had the Reading Company been separated from, instead of merged with, the Railway Company, no question would have arisen here with respect to the holding by the Reading Company of all of the capital stock of the Reading Iron Company. The merger of the Railway Company with the Reading Company makes the Railway Company the holder of the stock of the Reading Iron Company. This Court clearly intended by its opinion and its mandate that a decree entered in compliance with the mandate should not remove one form of illegality by substituting another. *United States v. St. Louis Terminal*, 236 U. S. 194, 205, 206.

We have sought to obtain the facts concerning the activities of the Reading Iron Company. But it is difficult to obtain them. Little is published, and little ap-

pears to be known. From the facts which, however, we have been able to gather and which we now submit to this Court, it would appear that the ownership of the stock of the Reading Iron Company by the Reading Company, after the merger, and the control exercised by the Reading Company over the Reading Iron Company would be repugnant to the provisions of the Commodities Clause.

The Reading Iron Company has issued and outstanding \$1,000,000 par value of capital stock, all of which is owned by the Reading Company. The Reading Iron Company was organized under the laws of the State of Pennsylvania on April 12, 1889. Its activities as set forth in Poor's Manual of Railroads of 1921, are (p. 1695) :

"* * * the manufacture of wrought iron pipes and tubes but it also owns and operates blast furnaces, rolling mills, forges and foundries at Reading, Pottstown, Columbia, Emaus, Birdsboro and Danville, Pa. and a large bituminous coal property in Somerset County, Pennsylvania."

The stock of the Reading Iron Company has been pledged as security under the joint General Mortgage of the Reading Company and the Coal Company. Dividends of 6% per annum have been paid. An extra dividend of \$1,500,000 was paid in 1909, one of \$1,000,000 in 1911, one of \$500,000 in 1914 and one of \$750,000 in 1915 (Poor's Manual of Railroads, 1921, p. 1695).

The Reading Iron Company has no mortgage indebtedness. A copy of its Balance Sheet as of December 31, 1920, is annexed as Appendix "C". It appears therefrom that the value applicable to the capital stock of \$1,000,000 is approximately \$22,000,000. The stock of the Reading Iron Company is carried on the books of the Reading Company at \$1,000,000 book value.

We are advised that the products of the Reading Iron Company are transported by the Railway Company or its subsidiaries and that it receives materials transported

over the rails of the Railway Company and its subsidiaries. We believe that the ownership by the Railway Company of all of the stock of the Reading Iron Company under the circumstances herein set forth is a violation of the Commodities Clause. Further investigation into the facts may be regarded as necessary and the Court has plenary power to direct the same.

The decree could, we respectfully submit, be brought in conformity with the law by directing that the stock of the Reading Iron Company be sold to purchasers independent of the Coal Company or of the Reading Company when merged with the Railway Company, free and clear of the General Mortgage, the proceeds to be subjected to the General Mortgage as set forth in II.

VI.

From such facts as we have been able to gather we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company creates a violation of Article 17, Section 5 of the Constitution of Pennsylvania of 1874.

The plan provides (par. 6, R. 276, 277) that the Reading Company when merged with the Railway Company will accept the Pennsylvania Constitution of 1874. Article 17, Section 5 of the Constitution of 1874 provides:

"No incorporated company, doing the business of a common carrier shall, directly or indirectly, prosecute or engage in mining or manufacturing articles for transportation over its works; nor shall such company, directly or indirectly, engage in any other business than that of common carriers, or hold or acquire lands, freehold or leasehold, directly or indirectly, except such as shall be necessary for carrying

on its business; but any mining or manufacturing company may carry the products of its mines and manufactories on its railroad or canal not exceeding fifty miles in length."

Had the decree of the District Court followed the language of the opinion of this Court and established entire independence of the Railway Company from the Reading Company no question involving the provision of the Constitution of Pennsylvania just quoted would arise. It is well settled that a decree entered pursuant to the mandate of this Court may not be repugnant

"to the exercise by the State authorities of their power * * * insofar as the jurisdiction of such authorities may have extended." (*United States v. St. Louis Terminal*, 236 U. S. 194, 207.)

From the facts set forth as to the activities of the Reading Iron Company in "V" it would appear to us that the holding of stock of the Reading Iron Company by the Reading Company when merged with the Railway Company is repugnant to the provisions of Article 17, Section 5, aforesaid.

Such would clearly appear to be the opinion of this Court as declared in *United States v. Reading Co.*, 253 U. S. 26. This Court, MR. JUSTICE CLARKE, writing, said (R. 17, 18):

"When in 1896 the problem was presented of reorganizing the financial affairs of the two companies, it was not solved, as it might have been, by creating separate coal and railroad companies to conduct independently interstate commerce in the two departments to which their railroad and coal properties were adapted, but, on the contrary, and very obviously for the purpose of evading the provision of the constitution of Pennsylvania prohibiting any incorporated common carrier from, directly or indirectly, engaging in mining 'articles' for transportation over its lines (Constitution of Pennsylvania,

1874, Art. 17, Sec. 5), and also of evading the provisions of the Federal Anti-Trust Act against restraining and monopolizing interstate commerce, *resort was had to the holding company device*, by which one company was given unrestricted control over the other two, with the power, inherent in that form of organization, of continuing and carrying forward the restraint and monopoly which had previously been acquired over that large volume of interstate commerce which was to be conducted by the coal and railroad companies. (Italics ours.)

Such would also appear to be the opinion of the Attorney General of Pennsylvania. His opinion, dated January 2, 1897, with respect to the right of the Reading Company to hold the stock of the Railway Company and the Coal Company is set forth in the Record (R. 252-258). If the Railway Company could under the laws of Pennsylvania hold the stock of the Coal Company there would have been no need to resort to the device of placing the ownership of the stock of both companies in a company organized prior to the Constitution of 1874 and free from the operation of the provisions thereof. The Attorney General said:

"It came to the notice of this Department that a plan of reorganization was contemplated, by which it was proposed that the stock of the two companies above mentioned should be held, owned and controlled by the corporation originally known as the Excelsior Enterprise Company, since changed to Reading Company, as above mentioned.

The obvious purpose of this part of the scheme of reorganization seemed to be to escape from that provision of the Constitution of 1874 which forbids any incorporated company doing the business of a common carrier, to directly or indirectly engage in mining or manufacturing articles for transportation over the line; or, stated differently, the union of the Coal Company with the Railway Company." (Italics ours.)

The provisions of Article 17, Section 5, were intended to achieve the same result with respect to intrastate commerce that the Commodities Clause sought to achieve with respect to interstate commerce. (*United States v. Delaware & H. Co.*, 164 Fed. 215, 253). It aimed at a destruction of the dual and conflicting relation of public carrier and private producer. Whatever difficulty there may be in enforcing its provisions and whether or not it may or may not require legislation to enable the State to forfeit title to lands acquired in the face of the provision (*Commonwealth v. N. Y., Lake Erie & W. R. R.*, 132 Pa. 591, 19 Atlantic, 291), we are of opinion that this Court will not approve of a combination which would infringe upon the inhibitions of Article 17, Section 5 of the Constitution of 1874 (*United States v. Delaware & H. Co.*, 164 Fed. 215, 253).

The violation of the Constitution of Pennsylvania may of course be obviated by directing a sale of the stock of the Reading Iron Company free and clear of the lien of the General Mortgage and the deposit of the proceeds of sale under the General Mortgage as suggested with respect to the stock of the Coal Company in II.

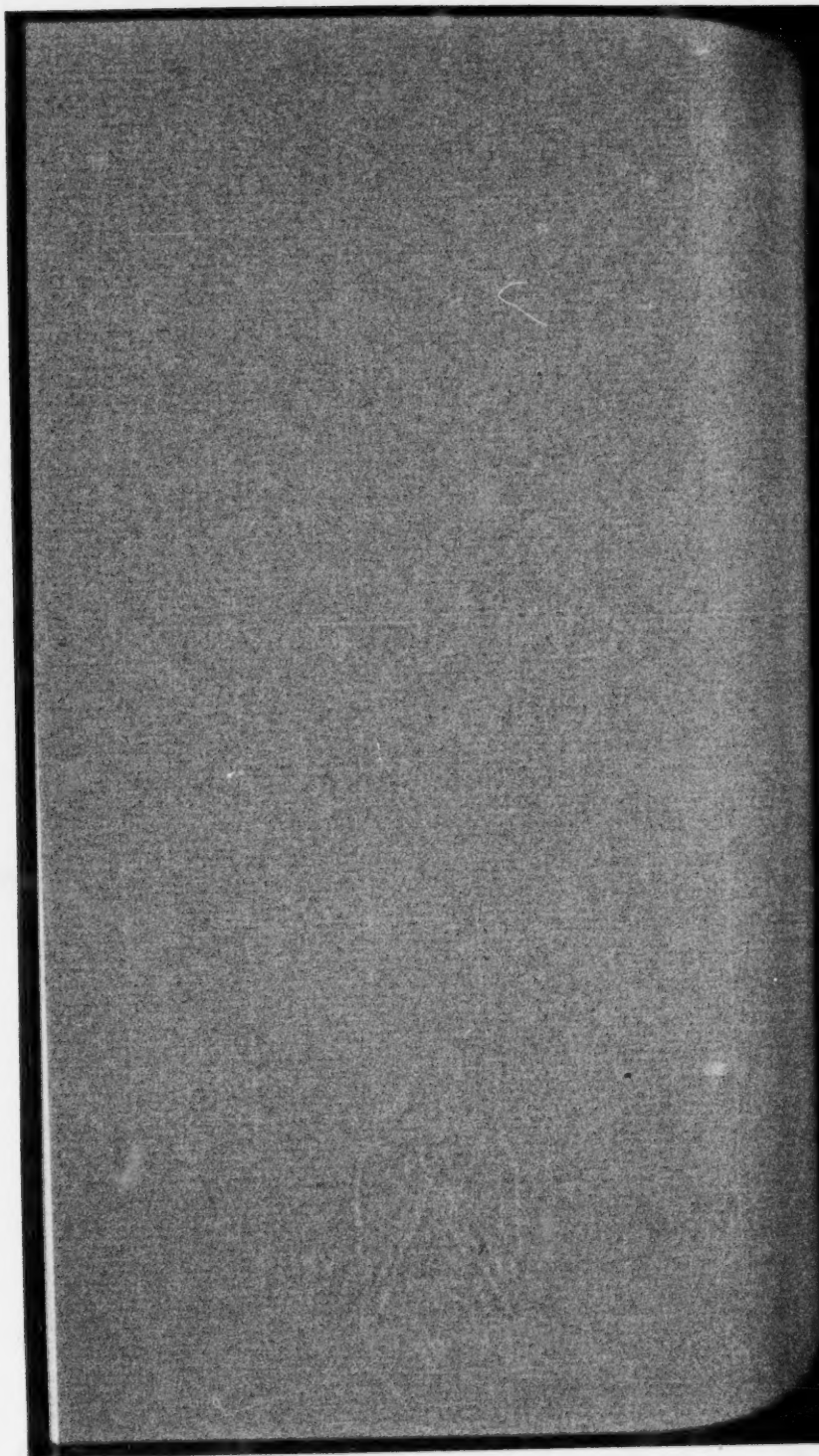
Respectfully submitted,

ALFRED A. COOK,
Attorney for Appellants.

ALFRED A. COOK,
FREDERICK F. GREENMAN,
ROBERT SZOLD,
of Counsel.



APPENDICES.



Appendix A.

No. 1584—IN EQUITY.

UNITED STATES OF AMERICA,
Plaintiff,

VS.

THE LAKE SHORE & MICHIGAN SOUTH-
ERN RAILWAY COMPANY, *et al.*,
Defendants.

In the United States
District Court for
the Southern Dis-
trict of Ohio,
Eastern Division.

Decided July 30, 1915.

Before WARRINGTON, KNAPPEN and DENISON, Circuit
Judges.

PER CURIAM. On May 22, 1915, the Sunday Creek Coal Company filed two petitions in the nature of interventions in the original suit, above named, in one of which petitions relief is asked against the Hocking Valley Railway Company, and in the other against the Bankers Trust Company; these three companies were defendants in the original suit (203 Fed. 295). The issues arising under the two petitions were presented and argued together, and will be disposed of in this opinion.

1. *Suit concerning Hocking Valley.* The relief sought against the Hocking Valley is to require the company to transfer and deliver to petitioner certain shares of stock in both the Buckeye Coal & Railway Company and the Ohio Land & Railway Company, and also particular mortgage bonds issued by the latter company. The Hocking Valley and the Chesapeake & Ohio Railway Company (another defendant in the original suit) moved to dismiss the petition concerning these securities, on the ground that the court is without jurisdiction to grant the relief

prayed. The Central Trust Company of New York, Trustee (another of the original defendants), filed an answer to this petition, alleging in substance that it holds such stocks and bonds as additional security for the payment of certain other bonds (\$20,000,000 face value) secured by the first consolidated mortgage of the Hocking Valley and the Buckeye companies, dated March 1, 1899.

One of the complaints made in the original suit in effect was that there was an unlawful combination of railroad and coal interests. One object of the decree was effectively to separate these interests so far as either interest interfered with the free and independent control of the other. The coal properties in question had prior to the original suit been placed in the nominal control of the Sunday Creek Company (now called Sunday Creek Coal Company), though the stock of that company was controlled by the railroad companies. For the purpose of placing the coal properties within the exclusive control of the Sunday Creek Company, it was provided in the decree that the equity and interest of certain named railroads, including the Hocking Valley, in the capital stock of the Sunday Creek Company, as also the legal title to such stock which then stood in the names of trustees, should be disposed of by absolute sale. Under a later order the stock was sold to John S. Jones, the sale was confirmed, and he and his associates are in control of the Sunday Creek Company. The theory of the present claim, as we understand it, is that this company became entitled to the stocks and bonds now in issue at the time the coal properties were placed in its nominal control, as stated, and so they are to be treated as having constituted part of the company's assets at the time Jones purchased its stock.

We shall for present purposes assume that if upon any sound theory the stocks and bonds in question were part of the property represented by the stock sold to Jones, and if the proper parties are present, the court has

jurisdiction under the powers reserved in the final decree to enforce the transfer and delivery sought, since the exercise of such power would in principle and effect be nothing more than to place the purchaser in possession of property intended to be embraced in the sale. The only evidence offered in support of the claim of petitioner is contained in portions of the record in the original suit, and such orders as have been entered in effecting the sale. The portions of the record most relied on are paragraphs (7), (8), (9) and (10) of the findings of fact accompanying the decree of March 14, 1914. The 7th paragraph deals with the railroad reorganization of 1899 (see also 203 Fed. at pp. 301, 302); the 8th with the Trunk Lines' purchase of stock in the Hocking Valley (*ibid.* p. 304); the 9th with the railroad acquisition and control of coal properties (*ibid.* 302 mid. to 303 near bot.); and the 10th with the merger of the coal interests in the control of the Sunday Creek Company (*ibid.* 303 bot. to 304 mid.). In view of certain undenied allegations of the petition it will not be necessary to enter into the details of all these findings. The 9th paragraph of the findings begins with a reference to the plan of reorganization bearing date January 4, 1899. All that need to be said here of the railroad feature of this plan is that it involved the reorganization of the immediate predecessor-railroad of the Hocking Valley, viz., Columbus, Hocking Valley & Toledo Railway Company, and that it resulted, as stated in paragraph (7), in placing the property of the reorganized railroad and of certain other railroad companies in control of the Hocking Valley. The 9th paragraph finds: the Hocking Valley and the Buckeye Coal & Railway companies joined in the execution of a mortgage of March 1, 1899, which provided for the issue of first-mortgage bonds in the sum of \$20,000,000. and for securing them through the properties acquired by the two companies; the Buckeye Company was organized for the purpose of taking over certain coal properties involved in the reorganiza-

tion mentioned; the purchasing trustees at the judicial sale bid in these coal properties and conveyed them to the Buckeye Company, receiving from the company 2495 shares of its capital stock of 2500 shares; the trustees then entered into a traffic agreement with the Hocking Valley and in consideration of which turned over to it the shares of coal stock so received; and out of sales proceeds of the first-mortgage bonds mentioned, the Hocking Valley acquired the stock and properties of four other coal companies, among which, as shown in the opinion in the original suit and here pointed out by counsel, were the stock and property of the Ohio Land & Railway Company (203 Fed. at 303). Still other stocks in coal companies were acquired by the Hocking Valley, as the 9th paragraph finds, and reference will be made to two of these companies when we come to consider the other petition.

The 10th paragraph (subdivision b) finds, among other things, that "The holdings in these coal properties were subsequently merged and placed in the Sunday Creek Company". Upon this language petitioner seems at last to rest its claim that the stocks and bonds in dispute are the property of the Sunday Creek Company. We do not think the language is open to such an interpretation, which would be opposed to the findings as a whole, and, indeed, to the facts deducible alone from the pleadings in the original suit. The findings show that the railroads and coal properties were separately grouped and placed under a common control. The question then of common control of the properties involved, whether railroad or coal properties, thus became and remained the issue of dominant importance rather than the means by which such control was acquired. For example, in a portion of the 10th paragraph, following the language so relied on and before quoted, and which describes the acreage of the coal lands and the number of coal mines and coke ovens, it is found that the Sunday Creek "controls" them, not that it owns them; and concededly, as will be seen, the

company controls the properties of the Buckeye and the Ohio Land & Railway companies by leases, not through ownership of the stocks and bonds in question. Upon turning to the pleadings of the original suit, admitted facts distinctly appear which negative the idea that the Sunday Creek Company acquired those stocks and bonds. By the 8th paragraph of the bill and the corresponding paragraph of the Hocking Valley answer, it was alleged and admitted that the Hocking Valley acquired the stock of the Buckeye and that of the Ohio Land & Railway Company. By paragraph XIV of the bill it was alleged that the Hocking Valley entered into an agreement of sale, in terms, of its coal stocks to the Central Trust Company, a copy of which agreement is attached to the bill as Exhibit E. This, it should be observed, is the same agreement which is set out in subdivision (b) of paragraph (10) of the findings, where the fact is found that in April, 1908, the entire capital stock of the Sunday Creek Company was placed in the names of two separate trustees, in anticipation of the effect of the commodities clause of the Hepburn act. This was done under separate though similar contracts by the Toledo & Ohio Central Railway Company (another defendant in the original suit) and the Hocking Valley, concerning the shares they respectively held (see also 203 Fed. at pp. 305, 306). As respects the contract so made between the Hocking Valley and its trustee (Central Trust Company), it is there stated (Findings, sub. b of par. 10) that all these shares "with others" were pledged to the trustee as collateral security for bonds issued under the first consolidated mortgage of the Hocking Valley and Buckeye companies. The other shares so alluded to appear by the same contract to be the shares of stock now in question and at that time to have belonged to the Hocking Valley. By the terms of the contract the shares were sold to the trustee subject to the lien of the first consolidated mortgage and "to the rights of the bondholders thereunder" (see, in addition to par.

10 of Findings, Exhibit E to bill in the original suit). The execution of this contract is admitted by paragraph XIV of the Hocking Valley answer.

Further, it sufficiently appears from the plan formed as early as June, 1915, for placing the coal interests of the railroads under control of a single company, that the securities now in dispute were never intended to be transferred to that company. The portion of the plan here applicable follows:

"First. Organize a corporation under the laws of the State of New Jersey * * * with a capital stock of \$4,000,000 * * *.

"Fourth. In order to permit the joint management of all the properties of the coal companies by one company, thus saving operating expenses and investment for equipment, by some one or more of the companies, the new company would lease the property of the Buckeye Coal & Railway Company, the Ohio Land & Railway Company * * * " (Vol. 5, Exhibit 17).

The evidence in the original suit shows that this plan was carried out, although we do not find copies of the leases in the record in that suit. It appears distinctly that the property of the Buckeye Company was leased to the Sunday Creek Company July 1, 1905; that the Sunday Creek Company holds the properties of both the Buckeye and the Ohio Land & Railway companies *under leases*; but in one of these showings only the unmined acreage is given, which does not correspond with the surface acreage admittedly embraced in the two leases; this is however cleared up by a letter of the president of the Sunday Creek Company, bearing date October 29, 1906, showing that the surface acreage substantially agrees with the acreage claimed under the present petition of the Sunday Creek Company. The existence of the leases and their dates as of July 1, 1905, appear in a mort-

gage which the Sunday Creek Company executed and delivered after the order confirming the sale of the stock to Mr. Jones was entered; this mortgage was presented with an application to the court for its action thereon, and reference to this subject will be made later; it is stated in the mortgage that both leases are of record in the counties in which the leased lands are situated.

Now, in spite of the relief sought through the present intervention, the facts deducible from the present petition of the Sunday Creek Company and the answer thereto of the Central Trust Company accord with the facts we have thus pointed out from the record of the original suit. It is alleged in the petition of the Sunday Creek Company, that the Hocking Valley "acquired ownership of all the stock of the said Buckeye Coal & Railway Company and still retains such ownership"; that "all the capital stock of said Ohio Land & Railway Company and all the bonds so issued by it as aforesaid, passed into the ownership of the Hocking Railway Company * * *"; that "the Hocking Railway Company still remains owner of all the capital stock of said Ohio Land & Railway Company and of its bonds issued as aforesaid * * *"; and that the Hocking Valley placed all of its stock in the Buckeye Company and in the Ohio Land & Railway Company, as well as all the bonds issued by the latter company, with the mortgage trustee named in the \$20,000,000 mortgage, as additional security for payment of the bonds covered by that mortgage. These allegations are virtually admitted by the present answer of the Central Trust Company. This answer in substance alleges, and it is nowhere denied, that as early as March 1, 1899, the Hocking Valley "conveyed" to the Central Trust Company the shares of stock in the Buckeye Company "upon the trust set forth" in the first consolidated (\$20,000,000) mortgage, and that all the capital stock of the Hocking Valley in the Ohio Land & Railway Company, and the bonds is-

sued by that company (\$1,200,000 par value, but it is admitted that the true amount is \$1,337,000), were deposited with the Central Trust Company as additional security for payment of such first-mortgage bonds. It is further alleged in the answer, and not denied, that \$16,044,000 face value of these first-mortgage bonds are still outstanding.

Any consideration of the facts above set out will inevitably show that the stocks and bonds in dispute were not, and also why they were not, turned over to the Sunday Creek Company. It was never intended that they should be. According to the original plan, the management of the coal properties now in question was to be placed in that company through leases, not through transfers of the lessor companies' capital stock or bonds; and the plan so devised was carried into execution. The stocks and bonds are held by the Central Trust Company in pledge, and the Hocking Valley has at most only an equity in them. Whatever this interest is, or whatever its value may be, it is perfectly clear that it never became an asset of the Sunday Creek Company, and so could not have been embraced in the sale of the capital stock of that company; and to hold that the interest was nevertheless included in the sale, would in effect be to sanction the confiscation of property. It is equally clear that so long as the Sunday Creek Company shall pay the royalties or rents reserved, and otherwise keep its covenants, under the leases, its ownership of these stocks and bonds is not necessary to its exclusive possession and control of the leased coal properties.

The decree, then, as it stands in the original suit, would seem now, as it did at the time it was entered, to afford complete and independent control of these leased coal properties, if the lessee should keep its covenants. It is to be remembered that in granting leave to the Government, April 18, 1913, to amend its bill of complaint by

adding new parties defendant, it was stated among other things in the court's order:

"* * * and it appearing to the court that all persons interested in the title to the stock of the Sunday Creek Company, and all persons holding any property pledged to secure the performance of the contract for dividing the coal traffic of the Kanawha and Hocking and the Continental Coal & Coke companies—as described in the opinion on file—are proper parties defendant; but that persons interested only in the title to the property of the Sunday Creek or its constituent companies, are not proper parties defendant".

The Buckeye and the Ohio Land & Railway companies being lessors, were not made parties, nor were they necessary parties. It does not follow, however, that the Hocking Valley should be permitted to retain the interests which seem to have brought about the present controversy. It in substance is alleged and denied that the present dispute has resulted alike in the withholding of payment for fuel coal purchased of the Sunday Creek Company by the Hocking Valley, and of royalties accruing under the two leases mentioned; it is practically conceded that the two coal companies are claiming forfeiture of the two leases by reason of such default in payment of royalties; and whatever may be the truth concerning such mutual withholding of payment, the obvious consequences of such a condition plainly call for an absolute sale of the interests of the Hocking Valley. Whether, burdened as these stocks and bonds are by the pledge, such a sale would have been ordered upon application presented at or before entry of the final decree, need not now be considered; certainly it was not suggested that such a condition as now seems to exist, might arise; and it must be conceded that such a condition was not foreseen by the court.

Appendix B.

- UNITED STATES.** Commissioners of Johnson County *v.* Thayer, 94 U. S. 631, 643; First National Bank *v.* Salem Flour Mills Co., 31 Fed. 580; Lowe *v.* Pioneer Threshing Co., 70 Fed. 646; Hamer *v.* Taylor Rice Engineering Co., 84 Fed. 392; *In re* S. P. Lumber Co., 132 Fed. 618; 140 Fed. 988; Burnes *v.* Burnes, 132 Fed. 485; *In re* Castle Braid Co., 145 Fed. 224; Allen *v.* Sugar Co., 193 Fed. 825; *In re* Tichenor Grand Co., 203 Fed. 720; *In re* Fechheimer Fishel Co., 252 Fed. 357.
- NEW YORK.** City Bank of Columbus *v.* Bruce, 17 N. Y. 507; Joseph *v.* Raff, 82 App. Div. 46, *affd.* 176 N. Y. 611; Hartley *v.* Pioneer Iron Works, 181 N. Y. 73; Moses *v.* Soule, 118 N. Y. Supp. 410; Richards *v.* Weiner, 145 App. Div. 353, *affd.* 207 N. Y. 65.
- MASSACHUSETTS.** New England Trust Co. *v.* Abbott, 162 Mass. 153; Leonard *v.* Draper, 187 Mass. 536.
- ILLINOIS.** Chicago P. & S. Co. *v.* Marseilles, 84 Ill. 643; Frazer *v.* Ritchie, 8 Ill. App. 554; Clapp *v.* Peterson, 104 Ill. 26; Commercial National Bank *v.* Burch, 141 Ill. 519; Rousch *v.* Illinois Oil Co., 180 Ill. App. 346; Olmsted *v.* Vance, 196 Ill. 243.
- CONNECTICUT.** Crandall *v.* Lincoln, 52 Conn. 73; Buck *v.* Ross, 68 Conn. 29.
- MICHIGAN.** Clark *v.* E. C. Clark Machine Co., 151 Mich. 416; Cole *v.* Cole Realty Co., 169 Mich. 247.

- WISCONSIN. *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585; *Marvin v. Anderson*, 111 Wis. 387; *Gilchrist v. Highfield*, 140 Wis. 476; *Atlanta & Walworth B. & C. Assn. v. Smith*, 141 Wis. 377.
- MINNESOTA. *State v. Minnesota Threshing Co.*, 14 Minn. 213; *Brown v. St. Paul Plough Works*, 62 Minn. 90; *Ray v. Litchfield*, 64 Minn. 306.
- TEXAS. *Howe Grain & Mercantile Co. v. Jones*, 21 Tex. Civ. App. 198; *San Antonio Hardware Co. v. Sanger*, 151 S. W. 1104.
- NEW JERSEY. *Chapman v. Ironclad Rheostat Co.*, 62 N. J. L. 497; *Berger v. U. S. Steel Corp.*, 63 N. J. Eq. 809.
- GEORGIA. *Hartridge v. Rockwell*, R. M. Charlton's Rep. 260; *Robinson v. Beall*, 26 Ga. 17; *Fitzpatrick v. McGregor*, 133 Ga. 332; *Dalton Grocery Co. v. Blanton*, 8 Ga. App. 809.
- NEBRASKA. *Fremont Carriage Co. v. Thomsen*, 65 Neb. 370; *Forrest v. Nebraska Hardware Co.*, 132 N. W. 839.
- IOWA. *Iowa Lumber Co. v. Forster*, 49 Iowa 25; *West v. Averill Grocery Co.*, 109 Iowa, 408; *Lumber Co. v. Telephone Co.*, 127 Iowa, 351.

Appendix C.

READING IRON COMPANY

BALANCE SHEET

December 31, 1920

ASSETS

Property Account

Real Estate, Plant and Equipment.	\$7,760,686.64	
Office Furniture.....	26,761.17	

\$7,787,447.81

Reserves for Depreciation, Depletion, etc.....	1,317,963.94	\$6,469,483.87
--	--------------	----------------

Current Assets

Cash	\$265,840.54	
Notes Receivable.....	164,013.49	
Accounts Receivable.....	1,378,641.36	
Inventories	9,160,841.70	10,969,337.09

Investments

Bonds, Stocks and Mortgages.....	\$9,425,268.50	
Insurance Fund.....	39,420.13	9,464,688.63

TOTAL..... \$26,903,509.50

LIABILITIES

Capital Stock.....	\$1,000,000.00
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Current Liabilities

Notes Payable.....	\$2,500,000.00	
Wages Accrued.....	465,250.00	
Wages Unclaimed.....	3,352.71	
Balance of Special Dividend 6/30/20	250,000.00	
Regular Dividend due Dec. 31, 1920	30,000.00	
Accounts Payable.....	1,748,094.62	
Installments a/c Emp. Sub. Liberty Bonds	315.95	4,997,013.28

Reserves

Reserve for Self-Insurance.....	\$39,420.13	
Reserve for Cash Discount on Sales	17,602.77	
Reserve for Bad Debts.....	9,172.54	66,195.44

Profit and Loss

Balance Jan. 1, 1920.....	\$21,791,553.78	
Loss Year 1920.....	141,252.91	

\$21,650,300.87

Dividends	810,000.00	20,840,300.87
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TOTAL..... \$26,903,509.50

4/21/21

JAN 10 1922
WM. R. STANSBURY
CLERK

IN THE
Supreme Court of the United States.

Nos. 609-610.

October Term, 1921.

CONTINENTAL INSURANCE COMPANY and FIDELITY-
PHENIX FIRE INSURANCE COMPANY OF
NEW YORK,

Appellants.

v.

READING COMPANY, et al.,

Appellees.

SEWARD PROSSER, MORTIMER N. BUCKNER and
JOHN H. MASON, as a Committee, Etc.,

Appellants,

v.

READING COMPANY, et al.,

Appellees.

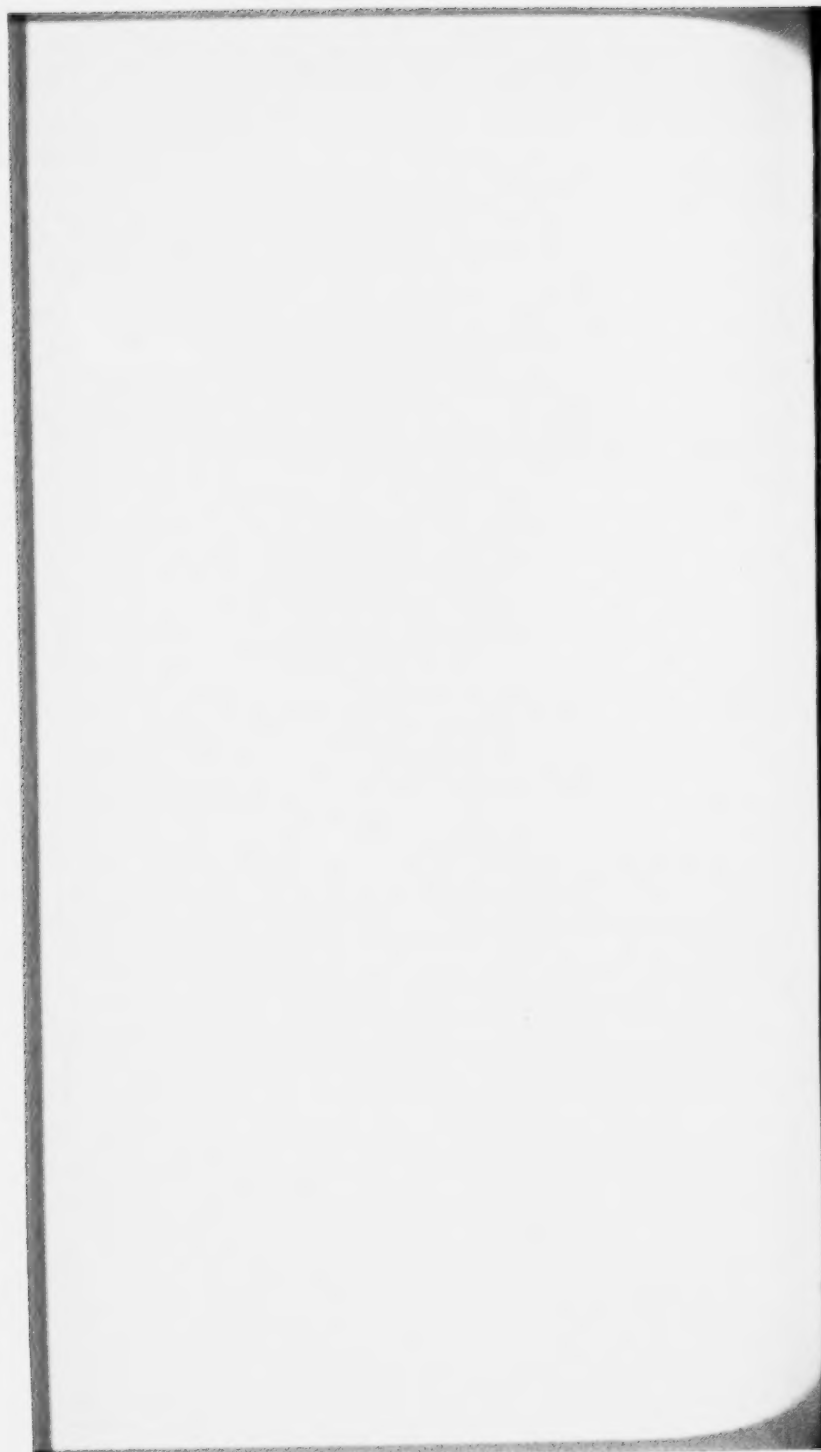
Appeal From the United States District Court for the
Eastern District of Pennsylvania.

Brief for William B. Kurtz and Madge Fulton
Kurtz, Holders of Preferred Stock,
Appellees.

THOMAS RAEBURN WHITE,
*Counsel for William B. Kurtz and Madge
Fulton Kurtz, Appellees.*

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IN THE
Supreme Court of the United States.

October Term, 1921. Nos. 609-610.

CONTINENTAL INSURANCE COMPANY AND FI-
DELITY-PHENIX FIRE INSURANCE COM-
PANY OF NEW YORK,

Appellants,

v.

READING COMPANY, ET AL.,

Appellees.

SEWARD PROSSER, MORTIMER N. BUCKNER
AND JOHN H. MASON, AS A COMMITTEE, ETC.,

Appellants,

v.

READING COMPANY, ET AL.,

Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR WILLIAM B. KURTZ AND MADGE
FULTON KURTZ, HOLDERS OF PRE-
FERRED STOCK, APPELLEES.

Appellants object to the plan approved by the
Court below on the ground that the proposed sale or
distribution of stock of the Coal Company to both pre-
ferred and common stockholders of the Reading Com-
pany violates the rights of the common stockholders.

They base their argument upon two contentions:

(1) That the necessary effect of the sale of the stock of the Coal Company, under the plan, to the stockholders of the Reading Company, is to distribute to them something of value which must be construed to be a dividend resulting in a diminution of the surplus of the Reading Company;

(2) That the surplus of the Reading Company belongs to the common stockholders exclusively and, therefore, that the distribution aforesaid cannot lawfully include the preferred stockholders but must be confined to the common stockholders alone.

Both of these positions are untenable. The sale or distribution of the stock of the Coal Company takes place pursuant to dissolution and liquidation of the Reading Company and not by way of the distribution of a dividend. And further, even if this distribution should be construed to be a dividend out of surplus it could not be paid to the common stockholders alone under any theory of the contract between the company and its stockholders.

The position of these appellees may be stated in three propositions, as follows:

1. The sale and distribution of the stock of the Coal Company to the stockholders of the Reading Company is made pursuant to the dissolution and liquidation of the Reading Company.

2. The preferred stock is subject to no limitation in the distribution of assets in case of dissolution or liquidation, but shares equally with the common stock.

3. The surplus of the Reading Company cannot under any circumstances be distributed in dividends to the common stock to the exclusion of the preferred

stock; consequently, even if the process of distributing the stock of the Coal Company should be deemed the payment of a dividend from surplus, it could not be distributed to the common stock alone.

These propositions will be discussed in order.

First.

The Sale and Distribution of the Stock of the Coal Company to the Stockholders of the Reading Company is Made Pursuant to the Dissolution and Liquidation of the Reading Company.

A consideration of the essential features of the organization of the Reading Company, its condemnation by this Court as illegal, the separation decreed by this Court to be made, and the plan under which this separation is to be brought about, should remove any doubt as to the essential nature of what is proposed to be done. It is a dissolution of the Reading Company, involving not merely the termination of the enterprise in which capital was originally embarked in 1896, but the complete disappearance of the corporate entity which now exists.

The last reorganization of the Reading properties took place in the year 1896 (Trans., pp. 213, *et seq.*). An old charter was made use of but for purposes of this discussion the situation is the same as if the Reading Company was then organized. To it were conveyed the various Reading properties mentioned in the plan of reorganization. Omitting details, these properties consisted of two business enterprises, *viz.*: (1) a transportation business, involving the ownership and operation of the Philadelphia & Reading Railway and its allied lines, and (2) a coal business involving the ownership and operation of extensive anthracite coal lands, collieries and equipment.

It is true, as alleged in the briefs of appellants, that the Reading Company was essentially a holding, not an operating, company. It owned certain railway equipment and owned all the stock of the Philadelphia & Reading Railway Company and all the stock of the Philadelphia & Reading Coal & Iron Company, as well as other securities, but it did not operate any of the properties. The object of this method of organization, however, was to control through one corporate entity the coal business and the transportation business in such manner as to result in a profit to the stockholders of the Reading Company; its effect was to violate the statutes of the United States, as this Court has found.

At that time this method of organization was believed to be legal, as is shown by the opinion of twelve of the leading lawyers of the United States (Trans., p. 251), and the public, including many of the present stockholders, invested money in the securities of the Reading Company, in view of the fact that the enterprise in which it was engaged offered unusual opportunities for profit by reason of the combination of the transportation business and the coal business.

The Court has now decreed that the combination of these two businesses under the circumstances shown by the evidence was illegal and has directed that the two shall be separated. In other words, that the business in which the stockholders invested their money can be carried on no longer.

What is the effect of this decree so far as regards the business enterprise in which the stockholders originally invested their money? Certainly it is brought to an end and the capital which was originally embarked in it should be returned to its owners, *viz.*, the stockholders of the Reading Company. This is recognized by the company and the plan provides for it. The first

step in this process is the distribution of the coal stock to such owners and the plan proposes that it shall be distributed in such a way that ultimately it will be entirely separated from the Reading Company or any of its stockholders. We refer to this as a distribution, not because we disagree with any contention to the contrary which may be made by other appellees, but in order that we may meet the argument of appellants on the ground they have chosen. That this distribution is pursuant to the dissolution and liquidation of the Reading Company is not open to doubt. The dissolution of a corporation in the sense in which the word is used in this connection means the termination of the business enterprise in which the money of the stockholders was invested and the distribution of the corporate assets to the owners thereof. It does not necessarily mean a technical dissolution of the corporate entity, although that also will follow in this case under the plan approved by the Court below.

It is not necessary to determine whether the stockholders would have a legal right to demand dissolution when the business in which their money was invested ceased to exist: It may be they would have. At any rate it cannot be questioned that they could legitimately object to being compelled to continue their investment in a business different from that in which they originally embarked their capital, and most certainly it cannot be doubted that the corporation can with propriety recognize this right and provide voluntarily for a dissolution and liquidation of the company. This is what the corporation has done in proposing the plan which the Court below approved.

Carefully prepared with the idea of interfering as little as possible with the immense business operations of the Reading Company, it proposes first that the stock representing the coal business shall be distributed

to the stockholders of the Reading Company, thus giving them a more direct interest in one of the two principal enterprises in which their capital was invested.

The plan might have provided for the distribution in a similar manner of the other stocks and securities held in the treasury of the Reading Company, but in order to disturb as little as possible the great business interests involved, it proposes that, instead of distributing such securities directly to the stockholders, the Reading Company shall merge with it the Philadelphia & Reading Railway Company, thereby vesting in a new consolidated company ownership of the property and securities belonging to both companies, including the railway properties and equipment. By this means the present stockholders of the Reading Company will acquire as direct an interest in the Philadelphia & Reading Railway as they would acquire if the stock of that company were distributed to them directly. The process is essentially the same—instead of giving them the stock of the corporation which owns the railway, the corporation of which they already own the stock merges into a new company, which becomes the owner of the railway and their stock becomes the stock of the consolidated company.

This merger will take place pursuant to authority contained in the charter of the Reading Company, which provides (Act of April 7, 1870, Sec. 4, Trans., p. 193), that the company (now the Reading Company) shall have power "to merge or consolidate, or unite with the said company (Reading Company) the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon."

The merger thus authorized will necessarily be brought about according to the method prescribed by the Act of the Commonwealth of Pennsylvania, approved May 3, 1909, P. L. 408.

This would necessarily be the fact in any case, as there is no other method provided by law whereby such a merger can take place. The said Act of 1909, however, must necessarily be invoked to supply authority for the Philadelphia & Reading Railway Company to enter into the proposed merger. The Philadelphia & Reading Railway Company was incorporated pursuant to the terms of the Pennsylvania Act of May 31, 1887, P. L. 278, which provides in effect that, upon a reorganization of, *inter alia*, a railroad, a new corporation may be formed by a reorganization committee, which shall have the same powers as the old corporation. By this means the Philadelphia & Reading Railway Company acquired all the powers of the old Philadelphia & Reading Railroad Company. (See opinion of counsel, Trans., p. 248.)

The Philadelphia & Reading Railroad Company was organized under the special Pennsylvania Act of April 4, 1833, P. L. 144. Neither this Act, nor any of its supplements, confers upon that company any independent right to merge with any other company; such right is, therefore, necessarily dependent upon general law, and the only applicable statute is the Act of 1909 above mentioned.

That the Philadelphia and Reading Railway Company could not enter into a merger or consolidation without statutory authority is plain.

Lauman v. The Lebanon Valley Railroad Co., 30 Pa. 42; 72 Am. Dec. 685;

in which the Supreme Court of Pennsylvania said regarding a proposed merger:

"No one will deny that, without the authority of the legislature, neither of these companies has power to enter into such a contract; for, as corporations, their powers are strictly limited to the province marked out for them in their charters."

Clearwater v. Meredith, 68 U. S. (1 Wall.)
25; 17 L. Ed. 604;

in which this Court said, referring to a power to merge (p. 39) :

“The power of the legislature to confer such authority cannot be questioned, and without the authority, railroad corporations organized separately, could not merge and consolidate their interests.”

While there are Acts of the Pennsylvania Assembly relating to the merger of railroad corporations, they are confined to the merger of companies owning connecting lines. As the Reading Company owns no lines of railway, these Acts are not applicable. The Act of 1909, *supra*, is therefore the only Act of Assembly which would permit the Philadelphia & Reading Railway Company to merge with the Reading Company or any other company except a railroad owning a connecting line, and, therefore, the merger must be made according to the terms of that Act. The method whereby the merger will be brought about is as follows:

A formal agreement between the Reading Company and the Philadelphia & Reading Railway Company, must be executed, setting forth the terms and conditions of the merger, the name of the new corporation, the names of the directors and officers, the nature of the stock issues of the new corporation, the manner of converting the capital stock of the old corporation into the new, etc. The merger must thereupon be approved by the stockholders of each corporation. Thereafter the agreement must be filed in the office of the Secretary of the Commonwealth and, when approved by the Governor, the new corporation will come into existence under the terms and with the powers specified in the agreement of consolidation. It is necessary that new letters patent

shall be issued by the Governor to the consolidated corporation, and thereupon the property of both companies shall become vested in the consolidated corporation, upon the terms specified in said act. The act provides on this point, as amended by the Act of April 29, 1915, P. L. 205:

“Such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent.”

It has been expressly held by the Superior Court of Pennsylvania that a merger under the said Act of 1909 has the effect of destroying the corporate identity of all merging companies.

In the case of *Pennsylvania Utilities Co. v. Public Service Commission*, 69 Pa. Superior Ct. 612, the Court, in discussing the said Act of 1909, used the following language:

“It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: *Railroad Co. v. Georgia*, 98 U. S. 359-362; *Pullman Palace Car Co. v. Missouri Pacific Railroad Co.*, 115 U. S. 587-594; 7 R. C. L., Sections 144, 145, 146, 147, and the many authorities there cited.”

The effect of a merger or consolidation, having particular reference to the question whether the merging corporations are dissolved is fully discussed in *Clearwater v. Meredith*, 68 U. S. (1 Wall.) 25; 17 L. Ed. 604; *Central Railroad Co. v. Georgia*, 98 U. S. 359; 25 L. Ed. 185; and *Yazoo & Mississippi Valley Ry. Co. v. Adams*, 180 U. S. 1; 45 L. Ed. 395; 21 Sup. Ct. 240. It may be that there are cases where one corporation may be merged into another in such a manner as to continue one of the merging companies in existence, but this can only be in cases where the statutes clearly authorize it and the prescribed method of consolidation permits it.

The cases above cited and many others referred to therein clearly show that the question whether the consolidation of two corporations results in their dissolution depends upon a construction of the statutes permitting the consolidation. Where the consolidation or merger under the terms of a statute necessarily results in a consolidated company with different powers and responsibilities from the constituent companies, and particularly if under the statutes it appears that a new franchise is to be conferred, the act of consolidation or merger is held to dissolve all of the merging companies.

In such case it does not matter that the name of the consolidated company may be the same name as one of the constituent companies, nor does it matter that the consolidated company will issue no new stock, but that the stock of one of the constituent companies will become the stock of the new company.

Yazoo & Mississippi Valley Ry. Co. v. Adams, 180 U. S. 1, *supra*. (See especially pp. 18 and 19.)

This case is the latest one in this court in which this question is extensively examined. In the course of the proceedings it became relevant and necessary

to determine whether the consolidation of the Memphis & Vicksburg Railroad Company with the Yazoo & Mississippi Valley Railway Company resulted in a dissolution of both companies and the formation of a new company. The Memphis & Vicksburg Road was authorized to consolidate with any other company whatever on any terms which it might agree upon with such other company. The Yazoo & Mississippi Valley Railway Company was in the same manner authorized to consolidate, and the consolidated company was to have and enjoy all the property and franchises of the previously existing companies. Under the agreement of consolidation which these companies entered into it was expressly provided that the corporate organization of the Yazoo & Mississippi Valley Railway Company should not be disturbed, and that if the same were legal the act of consolidation should not be construed to establish a new company; the name was to remain the same, Yazoo & Mississippi Valley Railway Company, and existing stockholders of the Yazoo Company were to retain their stock.

This Court held that upon a proper construction of the statutes, notwithstanding the terms of the contract of consolidation, it must be held that the effect thereof was to create a new corporation of the same name as one of the consolidating corporations. (See especially pp. 18 and 19.)

The discussion of the Court in this case, as in the others mentioned, clearly indicates that the question in all such cases will turn upon a proper construction of the statutes under which the consolidation takes place.

Whatever may be argued with regard to the power to merge or consolidate contained in the charter of the Reading Company, there can be no doubt that any consolidation which takes place under the

terms of the Act of 1909 necessarily must result in a new corporation to which new letters patent must be issued by the express terms of the statute. A mere reading of the statute makes this so plain that no argument is needed.

Other cases generally sustaining the proposition that a consolidation under circumstances similar to these results in a dissolution of both consolidating companies are as follows:

Shields v. Ohio, 95 U. S. 319; 24 L. Ed. 357;
St. Louis, etc., Ry. Co. v. Berry, 113 U. S.
465; 28 L. Ed. 1055; 5 Sup. Ct. 529;
Keokuk & Western R. Co. v. Missouri, 152
U. S. 301; 38 L. Ed. 450; 14 Sup. Ct. 592.

The result of the plan as a whole, therefore, will be that the assets of the Reading Company will have been distributed *pro rata* to the stockholders of Reading Company share and share alike, either through the sale and distribution of the coal stock or through the method of vesting in a new company all of the existing assets of both the Reading Company and the Philadelphia & Reading Railway Company, whereby existing stockholders of the Reading Company acquire a more direct interest in those properties. The fact that the Reading stockholders do not exchange their stock certificates for other certificates is immaterial. The stock which they own after the consolidation will be stock in a different company with powers and responsibilities different from the existing Reading Company.

It is said that the Reading Company will continue to exist. This is not correct. There will be, after the plan has been put completely in operation, a company known as the "Reading Company," but it will not be the Reading Company that now exists; the fact that

has the same name has been held to be an unimportant detail. It will be a new and entirely different corporation for which new letters patent must issue; it will be a common carrier; it will own a railway; it will have surrendered many of the powers now possessed and enjoyed by the Reading Company, and will possess others; it will be subject to the Constitution of Pennsylvania and to the respective Federal or State acts controlling common carriers or other public service companies. How can it be contended that the Reading Company continues to exist?

What, then, is the conclusion? What has happened? Clearly the following: The business in which the capital of the stockholder was invested has been held to be unlawful and has been dissolved by decree of this court; the assets constituting that business have been distributed to the stockholders in one form or another; the corporation itself has disappeared and ceased to exist, and another corporation of the same name has taken its place. If this is not a dissolution what is a dissolution?

There can be no doubt that when the plan has been put into effect the dissolution of the Reading Company will be final and complete.

The only question to be determined, therefore, is what are the rights of the stockholders in case of such dissolution, and this brings us to the second question.

Second.

The Preferred Stock is Subject to No Limitation in the Distribution of Assets in Case of Dissolution or Liquidation, But Shares Equally With the Common Stock.

It is correctly argued in the briefs filed on behalf of appellants that the respective rights of the preferred and common stockholders of this company de-

pend upon their contracts, as set forth in the stock certificates.

The contracts between the Reading Company and its stockholders show beyond possibility of question that in case of liquidation all classes of stock are entitled to share equally in the division of the assets of the company.

The material parts of the certificates of first preferred, second preferred and common stock appear hereinafter at p. 25.

An examination of these contracts discloses that they are entirely silent regarding the rights of any class of stockholders to participate in the division of assets in case of liquidation.

In the absence of statutory, charter or contract provisions to the contrary, preferred stock shares equally with common stock in the distribution of assets upon dissolution.

Cook on Corporations, Section 278;

14 *Corpus Juris*, 422, Section 580;

Fletcher Cyclopaedia Corporations, Section 3640;

Sternbergh v. Brock, 225 Pa. 279; 74 Atl. 166; 133 Am. St. Rep. 877; 24 L. R. A. (N. S.) 1078;

Englander v. Osborne, 261 Pa. 366; 104 Atl. 614; 6 A. L. R. 800;

Birch v. Cropper, L. R., 14 App. Cas. 525;

Hale v. Cheshire Railroad, 161 Mass. 443; 37 N. E. 307;

Jones v. Railroad, 67 N. H. 119; 38 Atl. 120;

Jones v. Railroad, 67 N. H. 234; 30 Atl. 614; 68 Am. St. Rep. 650;

Lloyd v. Penna. Electric Vehicle Co., 75 N. J. Eq. 263; 72 Atl. 16; 138 Am. St. Rep. 557; 21 L. R. A. (N. S.) 228; 20 App. Cas. 119;

Gordon's Ex'rs. v. R., F. & P. R. R. Co., 78 Va. 501;

Drewry-Hughes Co. v. Throckmorton, 120 Va. 859; 92 S. E. 818.

In *Cook on Corporations*, Seventh Edition, Section 278, the rule is stated as follows:

Upon the dissolution of a corporation, and the distribution of its assets among the stockholders after the payment of the corporate indebtedness, it is the settled rule of law that, in the absence of any provision in the statutes, by-laws, certificate of stock, or contract under which the preferred stock was issued, to the contrary, preferred stockholders have no priority over common stockholders. Their stock was preferred in respect of dividends, and not in reference to the capital stock. The assets of the corporation are to be distributed as though the preferred stock had been common stock. The preferred stockholder in the distribution becomes a common stockholder.

And in a note to Section 269:

There is nothing in the word "preferred" which restricts or cuts down the rights which at common law are inherent in all stock. It is settled law that upon dissolution the preferred stock shares *pro rata* with the common stock, in the distribution of the assets after payment of debts, even though such assets are in excess of the par value of both kinds of stock.

In *Englander v. Osborne*, 261 Pa. 366, *supra*, the Court used the following language (p. 369):

The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock.

Birch v. Cropper, L. R., 14 App. Cas. 525, *supra*, is the leading English case on the subject. This case involved the winding up of the Bridgewater Navigation Company and it appeared that the assets of the company were sufficient not only to pay the debts and the amount invested by the preferred and common stockholders, but to leave a large surplus for distribution. The common stockholders insisted that the whole of this surplus was profits, and that, as they were entitled to all of the profits after paying the five per cent. to the preferred stockholders, they were entitled to the whole of the fund. The Court held that this position was untenable, and that the rule contended for by the common stockholders applied only to annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect the decree was affirmed by the House of Lords. Lord Macnaghten said (p. 546) :

The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders, liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company.

In *Jones v. Railroad*, 67 N. H. 234, *supra*, a bill in equity was brought against the defendant railroad for an injunction to restrain the company from permitting preferred stockholders to subscribe to their proportionate share of newly authorized capital. The bill was dismissed. Replying to an argument of plaintiff the Court said:

The answer to the plaintiff's contention is readily seen when we inquire as to the meaning of the word "dividends," as used in the charter-contract. "The agreement that class one shall be entitled to six per cent. 'dividends from net earnings . . . and shall never be entitled to greater dividends,' and that 'classes two and three shall not be entitled to dividends from any source except that resulting from a saving of interest,' is a restriction of the described earnings and savings, and not of the right to dividends of capital." *Jones v. Railroad, supra*; *Cook Stock and Stockh.*, s. 278.

In *Drewry-Hughes Co. v. Throckmorton*, 120 Va. 859, *supra*, a case involving the rights of preferred stockholders, the Court used the following language (pp. 866, 867):

"After liquidation commences, preferred stockholders and common stockholders are, in the eyes of the law, upon the same plane, both being mere stockholders, excepting in so far as their participation in the assets of the company had been agreed upon between them."

The briefs filed on behalf of appellants misapprehend the nature of the contracts of the Reading Company with its stockholders. One-half of the stock of the company is referred to as preferred stock, but it is not preferred stock in the sense in which that word is commonly used. It does confer upon the holders of it a preference in the matter of distribution

of dividends from the current earnings of a particular fiscal year, but it confers no preference whatever in connection with the distribution of assets in case of liquidation.

As has been pointed out in the briefs of appellants, the future of the Reading Companies at the time of the reorganization in 1896 was problematical, and indeed doubtful, in view of their history. It is argued that the holders of preferred stock were given a position of greater security for a return of their investment than the holders of the common stock. This contention is without merit. The preferred stockholders received no preference in the distribution of assets, but took their chances with the common stock. If the operations of the company had been disastrous, so that its assets were depleted and liquidation resulted, the preferred stock would have received *pro rata* the same as and no more than the common stock.

Even regardless of the principle of law above referred to, that any stock, no matter what class, represents co-ownership of the company unless otherwise provided, it would seem in equity and good conscience that if investors in the preferred stock are subject to the hazards of the business, the same as investors in the common stock, they should participate in accretions of assets if the business is profitable.

It is difficult to ascertain from the appellants' briefs exactly what position they do take on this question. They do not argue that the preferred stock, in case of liquidation, is not entitled to share equally with the common stock, and inferentially at least this appears to be admitted, in view of the arguments in both briefs that the proceedings now under consideration do not involve a liquidation. Indeed, in the Walker brief it is substantially admitted that in case of liquidation the stock would share equally, where it is said

(p. 20): "The position of these appellants is that, at least so long as the *Reading Company* continues to exist and function, all of its surplus . . . belongs to the common stockholders," after payment of four per cent. dividends on the preferred stock.

Reference is made, however, at various points in appellants' briefs to the fact that there is reserved in the stock certificates a right to redeem the preferred stock at par, at the option of the company. It is nowhere argued, for it cannot reasonably be so argued in the absence of any such limitation, that the preferred stock is limited to par in the distribution of assets, but the references to the right of redemption seem to indicate that some such thought is in the mind of counsel.

But this reserved right has no bearing on the question under discussion. It is only an option, has not been exercised and under existing circumstances could not be exercised.

Whether it could legally be exercised after a dissolution and liquidation has been decreed with the effect of depriving the preferred stock of its rightful share of assets owned by the company need not now be considered. That question will be met if it ever arises.

Appellants devote a large part of their briefs to arguing that the four per cent. limitation of dividends contained in the preferred stock certificates is not only a limitation of the preference, but a limitation of the amount of dividends which preferred stockholders are entitled to receive.

It has not been contended at any stage of the case that the preferred stockholders are entitled to current annual dividends in excess of four per cent. Appellants, however, argue as if it were contended by appellees that the preferred stock is not limited to four per cent. dividends, and as if the question at

issue depended upon such a contention. They further argue that the Pennsylvania rule, as laid down in the cases which have been cited by both sides, regarding the construction of preferred stock certificates, is in conflict with certain cases which they cite from other States. The Pennsylvania rule referred to is that, where stock certificates provide for the payment to preferred stockholders of dividends at a certain rate, in preference to any payment upon common stock, but do not expressly provide that the preferred stock shall receive no further dividends, the limitation is construed to be not of the dividends, but only of the preference. Therefore, after the common stock has received the same amount as the preferred, the latter is entitled to share equally with the common.

Fidelity Trust Co. v. Lehigh Valley R. R. Co., 215 Pa. 610; 64 Atl. 829; 7 Ann. Cas. 613;

Sternbergh v. Brock, 225 Pa. 279; 74 Atl. 166; 133 Am. St. Rep. 877; 24 L. R. A. (N. S.) 1078;

Sterling v. H. F. Watson Co., 241 Pa. 105; 88 Atl. 297;

Englander v. Osborne, 261 Pa. 366; 104 Atl. 614; 6 A. L. R. 800.

It may be conceded that there are some cases, which on this point hold the contrary view, *viz.*, that where a preferred stock certificate expressly provides for the payment of dividends to preferred stock at a specified rate, in preference to dividends on the common stock, this, in the absence of any contrary provisions in the certificate, is to be treated as a limitation of the dividends as well as the preference.

This difference of opinion, however, as to the inferences to be drawn from the presence or absence of such provisions in a stock certificate, has nothing to

do with the case before the court. There is no decision which has been cited by appellants, or which exists so far as we know, which questions the rule that if a preferred stock certificate gives to the holders of preferred stock no preference and provides no limitation in case of dissolution, there is no limitation of the rights of the preferred stock to share in the assets.

The phraseology of the argument of appellants would seem to warrant the inference that they ask the Court to look upon the cases they cite as authority for the contrary proposition. But clearly they are not. The cases relied upon in both briefs are:

Stone v. U. S. Envelope Co., 119 Maine 394;
111 Atl. 536;

Russell v. American Gas & Electric Co.,
152 App. Div. (N. Y.) 136;

*Equitable Life Assurance Society v. Union
Pacific R. R. Co.*, 212 N. Y. 360.

These cases are not authority for the proposition that preferred stock is to be limited to its par value in the distribution of assets, merely because it is limited in dividends or because it is not expressly provided that it shall not be limited to its par value. In two of them the preferred stock was expressly limited to its par value in case of dissolution, and in the third it was held to share equally with the common stock.

In *Stone v. U. S. Envelope Co.*, 119 Maine 394, it was expressly provided that the preferred stock was limited to par in the distribution of assets. The Court said (p. 397):

"The parties by a contract embodied in the by-laws have provided for the preferred stockholders a seven per cent preferential dividend and in case of liquidation one hundred per cent. This excludes other participation." (Italics ours.)

In *Russell v. American Gas & Electric Co.*, 152 App. Div. (N. Y.) 136, the provision was thus stated by the Court (p. 137):

“The preferred stock is entitled to cumulative dividends at the rate of six per cent per annum and to preference in the distribution of assets *until the par value and accumulated dividends have been paid and ‘to no further dividend or distribution.’*” (Italics ours.)

In *Equitable Life Assurance Society v. Union Pacific R. R. Co.*, 212 N. Y. 360, the Court, at page 367, expressly disclaimed any intention to make any rule regarding the distribution of any accretion or increment of capital of a going corporation which had become a part of the permanent capital of the company. The Court did, however, in passing, say (p. 366):

“If, on the other hand, all or part of the gains which it is proposed to distribute are accretions to and have somehow become permanent capital and been withdrawn from availability for dividends it will be assumed that they must be distributed amongst all the stockholders.”

It is, therefore, apparent that in this case the Court, while finding that the preferred stockholders were not entitled by reason of the provisions of the contract to dividends in excess of four per cent, nevertheless assumed that in case of distribution of assets they would have been entitled to share equally with the common stock.

These cases, therefore, are clearly not authority against the position assumed by appellees in this case, which is that, in the absence of any provision in the contract giving the preferred stock a preference in the distribution of assets or limiting it to its par value in case of such dissolution, all classes of stock are entitled to share equally.

One other point remains to be noticed. It is argued in the briefs filed on behalf of the appellants, and correctly argued, that if a construction of a contract such as this, widely circulated among investors, has been adopted and for years has gone unchallenged, it should be given weight by the Court as a contemporaneous practical construction of the contract. In 1904, nearly eighteen years ago, an application was made to list the preferred stocks of the Reading Company on the New York Stock Exchange. In this application a statement was made as follows (Trans., p. 181):

“The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets.”

This public declaration unquestionably came to the knowledge of brokers and others dealing with securities, and received very wide publicity. So far as the record appears, and in fact, there had been no dissent or objection thereto from that time until the present, although the statement has been repeated both in writing and orally many times. There is no doubt that the preferred stock has been commonly understood, not only by the Reading Company, which signed the application to list the preferred stocks on the New York Stock Exchange, but by brokers dealing in the stock and by the public generally to have a right to share equally with the common in case of dissolution. While this, of course, is not conclusive, it should have weight as indicating a contemporaneous practical construction by the parties to the contract.

The above considerations make it clear that the preferred and common stocks are entitled to share equally in case of dissolution, and inasmuch as the distribution now under consideration is made in pur-

suance of a dissolution, all classes of stock are entitled to share equally.

It may be added that if anyone has the right to complain of the plan of dissolution, it is the preferred and not the common stockholders. The preferred stockholders could legitimately object to being compelled to continue their investment in the new consolidated Reading Company, which now becomes exclusively a railway operating company, subject to the limitation of four per cent. from current earnings. If they continue as stockholders of the new Reading Company, they can reasonably demand to be placed on the same basis as the common stock. Preferred stockholders, however, have by their general approval of the plan expressed a willingness for the sake of a prompt adjustment of these matters, to continue their investment in the Reading Company as a four per cent. preferred stock, provided they are given their proper share in the distribution of the coal stock. Of this, the common stockholders have no right to complain.

Third.

The Surplus of the Reading Company Cannot Under Any Circumstances be Distributed in Dividends to the Common Stock to the Exclusion of the Preferred Stock; Consequently, Even if the Process of Distributing the Stock of the Coal Company Should be Deemed the Payment of a Dividend From Surplus, it Could Not be Distributed to the Common Stock Alone.

In order to succeed in this appeal appellants must convince the Court of the soundness of two propositions, (1) that the distribution under consideration constitutes not a distribution of assets in liquidation, but a dividend declared and paid out of surplus; (2) that if a dividend be declared and paid out of surplus

it must go to the common stock alone, and that none of it can lawfully be distributed to the holders of preferred stock.

It has already been demonstrated that the first proposition is erroneous; the second also is without legal basis on which to rest. Even if the distribution should be considered to be a dividend declared and paid out of surplus by an operating company, it could not be paid to the common stock alone.

An examination of the contracts between the Reading Company and its various classes of stockholders makes this clear; dividends on the common stock cannot be paid out of "undivided net profits remaining from previous years," constituting the surplus, but only out of earnings of the preceding fiscal year in which the full dividends on the preferred stock have been paid out of the earnings of that year. The material parts of the certificates of the three classes of stock are as follows:

FIRST PREFERRED STOCK.

"The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular

fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

“Such First Preferred Stock is authorized to the amount of twenty-eight million dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding, given at a meeting of the Stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, as well as to the creation of any mortgage additional to that for \$135,000,000 heretofore authorized, except that, at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased, without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and accordingly, this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may so increase and issue its First Preferred Stock.

“The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.”

SECOND PREFERRED STOCK.

“The Second Preferred Stock is entitled to non-cumulative dividends, at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any

payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

"Such Second Preferred Stock is authorized to the amount of forty-two million dollars; and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, or of the First Preferred Stock, as well as to the creation of any mortgage additional to the mortgage of \$135,000,000 heretofore authorized.

"The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of four per cent. per annum shall have been paid for two successive years on the First Preferred stock, the Reading Company, without further consent from the holder or owner hereof, may exercise the right to convert the Second Preferred

Stock, not exceeding \$42,000,000 at par, one-half into First Preferred Stock and one-half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock.

“The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

“The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding, according to the preferences thereof.”

COMMON STOCK.

“First Preferred Stock has been authorized to the amount of twenty-eight million dollars, and Second Preferred Stock to the amount of forty-two million dollars; and a Mortgage has been authorized to the amount of \$135,000,000 and the consent of the holders of at least a majority of such part of the Common Stock as shall be represented at a meeting of stockholders called for that purpose is necessary to any increase of such authorized amount of First Preferred Stock or Second Preferred Stock, as well as to the creation of any additional mortgage; provided, that without further consent, at any time after dividends at the rate of four per cent. per annum shall have been paid on the First Preferred Stock, for two successive years, the Second Preferred Stock, not exceeding \$42,000,000, may be converted at par, one-half into First Preferred Stock and one-half into Common Stock, and that for such purpose and to such extent the Reading Company may increase and issue its First Preferred Stock and its Common Stock.

“The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

"The Common Stock is subject to the prior rights of holders of all classes of Preferred Stock at any time outstanding, according to the preferences thereof.

"If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

There are certain conclusions readily apparent from examining these contracts, which may be stated thus:

(1) In case of liquidation, the holders of preferred stock have no preference in the distribution of assets and are not limited to the par value of the stock held by them.

This has already been discussed.

(2) The preferred stock is entitled to four per cent. non-cumulative dividends out of the earnings of any fiscal year in preference to any dividends upon the common stock from the earnings of that year.

In view of the contemporaneous practical construction of this contract, as pointed out in the briefs of appellants, it may be assumed, although under the decisions of *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, 215 Pa. 610; 64 Atl. 829; 7 Ann. Cas. 613; *Sternbergh v. Brock*, 225 Pa. 279; 74 Atl. 166; 133 Am. St.

Rep. 877; 24 L. R. A. (N. S.) 1078; *Sterling v. H. F. Watson Co.*, 241 Pa. 105; 88 Atl. 297; and *Englander v. Osborne*, 261 Pa. 366; 104 Atl. 614; 6 A. L. R. 800. It would otherwise be very doubtful, that the four per cent. dividend specified in the stock certificates is a limitation not only of the preference, but of the dividends which the preferred stockholders may receive out of the earnings of such year.

The stock certificates, however, contain certain provisions regarding the sources from which such dividends may be paid which are most important in this connection. They may be stated thus:

(3) Such dividends to holders of preferred stock may be paid from the accumulated earnings or, in other words, from the surplus of the Reading Company.

(4) Such dividends to common stockholders may not be paid from accumulated earnings of previous years, but may be paid only from surplus earnings of *the previous fiscal year, after* the full dividends for that year to the preferred stockholders have been paid *out of the earnings of that year.*

These last two propositions appear from a careful analysis of this contract.

The source of dividends on the preferred stock is thus stated in the first preferred stock certificate (*italics ours*).

“The first preferred stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; *but only from undivided net profits of the company* when and as determined by the board of directors, and only if and when

the board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the first preferred stock, there shall remain any *surplus undivided net profits*, the board out of such surplus may declare and pay dividends for such year upon the second preferred stock."

It will be observed that the source of dividends on the preferred stock is described in this certificate in two places as "undivided net profits" of the company. There can be no doubt under this language that dividends on the preferred stock can be declared out of surplus, under the general principles applicable in such cases. This, however, is made more clearly evident by the provisions relating to the source of dividends on the common stock, which very certainly and in markedly different terms describe the source of such dividends as being confined to surplus earnings of a particular year.

These provisions as to the common stock are as follows (*italics ours*):

"If, from the business of any particular fiscal year, *excluding undivided net profits remaining from previous years*, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, *and out of such surplus net profits of such year may pay*, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

It is thus seen to be most carefully provided that dividends on common stock must come exclusively

from the business of a particular fiscal year "excluding undivided net profits remaining from previous years," and after the dividends on the preferred stock have not only been declared, but paid for that year *out of the net profits of that year*. In other words, no dividend can be declared upon common stock out of the earnings of any year in which the directors have been compelled to resort to the surplus in order to pay dividends on the preferred stock.

These provisions are unusual but, it is submitted upon a careful analysis of the contract, unquestionable, and upon reflection it is readily understood why the contract contained such terms.

The dividends payable to the preferred stock were non-cumulative, and, therefore, in order to make the stock valuable, it was necessary to adopt some plan to make it reasonably certain that its dividends would be regularly paid. This guarantee of such regular payment is found in the provisions above quoted. Every year after payment of dividends there would naturally be surplus earnings going into general surplus which year by year would thus be built up. If subsequently the earnings of the company should diminish, dividends on preferred stock might still be paid so long as any undivided net profits remained from previous years.

In order, however, to preserve this surplus for the purpose of making more certain the payment of dividends on the preferred stock, it was very carefully provided that the surplus consisting of "undivided net profits remaining from previous years" could not be diminished under any circumstances by the payment of dividends on common stock, and that in any year in which the surplus had been reduced by paying dividends on preferred stock, no dividends whatever on common stock could be paid.

This arrangement was a reasonable one and was intended to place the preferred stock on a better basis than an ordinary non-cumulative stock, with no such restrictions as to dividends on common stock.

The clear intent of the contracts was to provide that the directors of the Reading Company should at the close of each fiscal year determine what the profits of that year would justify by way of dividends; and if there were sufficient net earnings in that particular year to pay dividends on both first and second preferred stock, to permit the payment of a dividend also on the common stock; thereafter, or in either case, the surplus remaining was to go automatically and at once into the general surplus, where, as constituting "undivided net profits remaining from previous years," it was out of the reach of the directors so far as regards dividends on the common stock alone, being expressly excluded as a source of dividends on such stock; it was, however, subject to call in case of deficiency in current earnings to pay dividends on preferred stock.

In order to make more certain the protection of the preferred stock, the sentence last above quoted was inserted, reading:

"But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

The peculiar wording of the sentence last above quoted is made the basis of a contention that the directors could under some circumstances declare dividends out of surplus, owing to the expression "any previous fiscal year." It is argued that by prohibiting the payment of dividends on common stock out of the net profits of any previous fiscal year, in which the full

dividends had *not* been paid on the preferred stock, it was intended to permit the payment of such dividends on common stock out of the accumulated earnings of all previous years in which the full dividends *had* been paid upon the preferred stock and thus to free the surplus for this purpose. This view of the contract, however, is inadmissible. The sentence in prohibitory form was clearly intended to re-enforce the sentence immediately preceding it, which was positive in character, and it is quite apparent that the reference to "any previous fiscal year" means any fiscal year out of the earnings of which dividends were then being declared or were under consideration. If it did not mean this, it would directly contradict all that had gone before and by mere inference would place at the disposal of the directors in declaring dividends on common stock "undivided net profits remaining from previous years," which, under the terms of the contract, are expressly excluded.

It is so clearly provided elsewhere that dividends on common stock can be paid only out of the profits of a particular fiscal year, excluding undivided profits from previous years that unless the contract be deemed to contradict itself we are bound to interpret "previous fiscal year" in this connection as meaning any previous fiscal year for which dividends on all classes of stock are about to be declared, and it clearly does mean this.

The practice of the Reading Company conforms to this construction. The declaration and payment of dividends are made at or after the close of the fiscal year, and out of the earnings of that year. Consequently, the reference to any "previous fiscal year" was proper, for it is necessarily a *previous* fiscal year from whose earnings the final determination as to the amount of dividends is made.

It appears from the minutes of the meeting of the Board of Directors held in December, 1920, that in that month provision was made for the payment during the succeeding year, from and out of the earnings of the fiscal year then about to close, of the full dividends on the first and second preferred stock (Trans., p. 94). It further appears that no dividends on common stock were declared until after provision had been made and the cash set aside for the payment of the full dividends in 1921 on the preferred stock. It will be noted that all the dividends paid in the year 1921, both on preferred and common stock, were (and necessarily were, for the contract so requires) paid out of the earnings of the fiscal year 1920. Further, dividends on the common stock could not be declared out of the earnings of the fiscal year 1920 until after the cash had actually been set aside for payment of the full dividends on the preferred stock, which to comply strictly with the sentence now under discussion was done "in" that year or 1920. This makes perfectly clear the language of the certificate under discussion. Dividends on common stock are always paid out of the earnings of a *previous* fiscal year. The only purpose, therefore, of the sentence under discussion was to re-enforce the provision earlier contained in the contract, that no dividends could be paid on the common stock, out of the earnings of "any previous fiscal year," unless full dividends on the preferred stock had in fact been paid "in" that year.

This is a clear and consistent meaning for the sentence under discussion. It is in harmony with the foregoing portions of the contract and it must, therefore, be adopted as the true construction; certainly, it must be accepted as against the construction contended for by appellants, which would make the sentence now under consideration contradictory of the earlier provisions in the same contract.

It is argued by appellants that the directors of the company, having declared a dividend on the common stock, out of the surplus earnings of a particular fiscal year, in which the full dividends on the first and second preferred stock had been paid, may in later years repeat the process in such way as to finally exhaust the surplus.

This argument entirely ignores the words "excluding undivided net profits remaining from previous years," which distinctly limit the source from which such dividends on common stock can be declared, to the net profits of the particular fiscal year in question. These words certainly mean something and no meaning has been or reasonably can be suggested other than that they were intended to prevent the very thing which appellants argue may be done, namely, the distribution of accumulated earnings from previous years as dividends on the common stock alone. It is not easy to see how words could more plainly prohibit such a distribution.

It would be unreasonable to carefully prevent the directors from declaring dividends on common stock out of "undivided net profits remaining from previous years," and to prevent them from paying any dividends whatever on common stock in any year in which the surplus had been reduced by the payment of dividends on the preferred stock, and at the same time permit them in their discretion to distribute the entire surplus among the common stockholders. Such a construction would render meaningless the very careful provisions in these certificates for the protection of the preferred stockholders.

It may then be inquired whether the surplus must be maintained indefinitely as a source out of which dividends may be paid on the preferred stock alone, or whether it may be distributed to all classes of stock alike.

It clearly must be one or the other, for in declaring dividends on the common stock alone "undivided net profits remaining from previous years" must be excluded, which necessarily eliminates the contention made by counsel for the common stockholders that the surplus could be distributed exclusively to that class of stock.

We think the most reasonable view to take is that the surplus is in the same position as capital assets, so far as regards any right to distribute the same. It is probable that the preferred stockholders could insist upon a reasonable surplus remaining to guarantee the payment of their dividends in case the net earnings of the company should at any time be insufficient. But it seems unreasonable to require a very large surplus, accumulated either from earnings or from accretions of capital assets, to be maintained indefinitely, and we are inclined to the opinion that it may, within the reasonable discretion of the directors, be distributed to all classes of stock alike.

It is, however, unnecessary to discuss further the question as to what could be done with the surplus, if the Reading Company were to continue in operation. It is plain that it could not be distributed to the common stock alone, and this is a complete answer to the argument which appellants advance. It is equally clear that a legal objection to its distribution, even in such a case, could be made only by the preferred stockholders, and they have made no objection.

It necessarily follows from the considerations above discussed that:

(1) The sale and distribution of the coal stock to the stockholders of the Reading Company is one step in the process of the dissolution of the Reading Company and the distribution of its assets, pursuant to

the terms of the plan, which has been approved by the Court below and meets the approval of the great majority of all classes of stock.

(2) All classes of stock of the Reading Company are entitled to share equally in the distribution of assets in case of dissolution.

(3) Even if the distribution of the coal stock should be construed to be a dividend declared out of surplus by a company in full operation, it could not be paid to the common stock to the exclusion of the preferred stock, because by the terms of the contracts between the company and its stockholders, dividends to common stockholders cannot be paid out of surplus constituting undivided net profits remaining from previous years.

The appeals should, therefore, be dismissed, and the action of the Court below should be affirmed.

T. R. WHITE,

*Counsel for William B. Kurtz
and Madge Fulton Kurtz, Appellees.*

JAN 10 1922

WM. R. STANSBURY
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IN THE

Supreme Court of the United States

October Term, 1921, Nos. ~~608~~, ~~609~~

609-610

CONTINENTAL INSURANCE COMPANY, *et al.*, *Appellants*,

VS.

READING COMPANY, *et al.*, *Appellees*.

SEWARD PROSSER, *et al.*, as a Committee, etc., *Appellants*,

VS.

READING COMPANY, *et al.*, *Appellees*.

BRIEF ON BEHALF OF ADRIAN ISELIN *ET*
AL., AS A COMMITTEE REPRESENTING
CERTAIN FIRST AND SECOND PREFERRED
STOCKHOLDERS, APPELLEES.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,
Counsel for Adrian Iselin et al., Appellees.



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IN THE
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October Term, 1921, Nos. 608, 609.

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VS.

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SEWARD PROSSER, *et al.*, as a Committee, etc., *Appellants*,

VS.

READING COMPANY, *et al.*, *Appellees*.

**BRIEF ON BEHALF OF ADRIAN ISELIN ET AL.,
AS A COMMITTEE REPRESENTING CERTAIN
FIRST AND SECOND PREFERRED STOCK-
HOLDERS, APPELLEES.**

Statement.

On the previous appeal in this case, this Court held (253 U. S., 26) that the scheme of reorganization of the Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company adopted December 14, 1895, "combined and delivered into the complete control of the board of directors of the Holding Company," *i. e.*, the Reading Company, "all of the property of much the largest single coal company operating in the Schuylkill anthracite field and almost one thousand miles of railway over which its coal must find its access to interstate

markets," and that this constituted a combination unduly to restrain interstate commerce within the meaning of the Act (253 U. S., p. 48).

"The Reading Railway Company and the Reading Coal Company each had thereafter but one stockholder—the Holding Company—and their earnings were to be distributed, not in proportion to the shares of their capital stocks, aggregating \$28,000,000, but were to go to the creditors and shareholders of the Holding Company, with its mortgage debt of \$135,000,000 and its capital stock of \$140,000,000. The Holding Company thus served to pool the property, the activities and the profits of the three companies" (*ib.*, p. 48; Rec., p. 9).

The Court then noted the use which was made by the combination of the powers secured through the holding company, and held:

"For flagrant violation of the first and second sections of the Anti-Trust Act, the relations between the Reading Company, the Reading Railway Company and the Reading Coal Company and between these companies and the Central Railroad Company of New Jersey must be so dissolved as to give to each of them a position in all respects independent and free from stock or other control of either of the other corporations" (253 U. S., 59, 60; Rec., p. 21).

Finally, the Court concluded as follows:

"It results that * * * as to the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company and the Central Railroad Company of New Jersey, the decree of the District Court will be reversed and the cause remanded with directions to enter a decree in conformity with this opinion, dissolving the combination of the Read-

ing Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various Companies held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company * * * (pp. 63-64; Rec., p. 24).

After this decision, the Reading Company moved this Court to modify the decree to be entered on the decision, by authorizing the District Court to consider and approve or reject petitioner's plan "for a form of decree which would permit of the holding by the Reading Company of the stock of either the Philadelphia and Reading Coal and Iron Company or the Philadelphia and Reading Railway Company, provided the Reading Company had disabled itself from exercising any influence upon the conduct of the business of the other of the said Companies and of the Lehigh and Wilkes-Barre Coal Company and the Central Railroad Company of New Jersey * * *."

The Government opposed this motion, upon the ground that

"the District Court under such a modification would clearly be authorized to consider, not only plans for the retention by Reading Company of one of its subsidiaries, but also what arrangements short of an actual *disposition* of the stocks, bonds and property of the other controlled Com-

panies would *disenable* the Reading Company from 'exercising any influence upon the conduct of either businesses.' "

The motion was denied by this Court without opinion (253 U. S., 478).

The decree of this Court, therefore, in effect was, that the Reading Company should no longer be permitted to hold the stock of either the Philadelphia and Reading Railway Company, or the Philadelphia and Reading Coal and Iron Company, or the other corporations mentioned in the decree, and the decree on the mandate from this Court entered in the District Court, accordingly required the defendants to submit to that Court

"a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various Companies, held by the Reading Company as may be necessary to establish the entire independence from that company and from each other of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, to the end that the affairs of all those now combined companies may be conducted in harmony with the law" (Rec., pp. 36, 37).

THE REQUIREMENT TO STRIP THE READING COMPANY OF ALL OF ITS INTERESTS IN THE FOUR OTHER CORPORATIONS NAMED, WAS, IN EFFECT, A DECREE OF LIQUIDATION, FOR THOSE INTERESTS CONSTITUTED SUBSTANTIALLY ALL OF ITS PROPERTY.

The Plan formulated by the Reading Company to

comply with such decree (Rec., p. 40), and the modified Plan finally approved by the District Court (Rec., pp. 274, 287, *et seq.*), required the Reading Company, first, to divest itself of all interest in the Coal Company, and then to merge itself with the Philadelphia and Reading Railway Company, the Reading Company agreeing to accept the Pennsylvania Constitution of 1874, and to surrender all of the powers conferred by its existing charter which are inappropriate to a railroad corporation of Pennsylvania, and thus

“the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated” (Rec., p. 277).

Other provisions of the Plan and the decree provided for the separation of the stocks of the other Companies—the Central Railroad Company of New Jersey, the Lehigh and Wilkes-Barre Coal Company, etc.

This virtual dissolution of the Reading Company, involving the distribution of substantially all of its assets and the merger of its identity with that of the Philadelphia & Reading Railway Company under a changed corporate status, although retaining the same name, in effect terminates the existence of the present Reading Company, provides for a distribution of substantially all its assets and their distribution to (1) a new consolidated or merged railroad corporation and (2) a new corporation to hold the beneficial interest in the Coal properties.

By this Plan, the Reading Company agrees to assume the \$96,524,000 General Mortgage Four Per Cent. Bonds which are the joint obligations of itself and the Coal & Iron Company, and to secure which all the capital

stock of the Coal & Iron Company is pledged, and to save that Company and its assets harmless therefrom, and at or before the maturity of said bonds, to obtain the release of the Coal Company's properties from the lien of the General Mortgage and the discharge of the Coal & Iron Company from liability on said bonds.

The Coal & Iron Company will pay to the Reading Company, \$10,000,000 in cash or current assets and \$25,000,000 in its 4 per cent. mortgage bonds maturing the same date as the said General Mortgage Bonds. The Reading Company and the Coal & Iron Company shall release each other from all claims and liabilities of either against the other, including a claim of approximately \$70,000,000 carried on the books of the Reading Company as an asset and on the books of the Coal & Iron Company as a liability.

The Reading Company is then to sell, assign and transfer, subject to the lien of the General Mortgage, all of its interest in the stock of the Coal & Iron Company, including its present right to vote and receive dividends thereon, to a new corporation, to be formed with appropriate powers, which shall become a party to this cause and be subject to the decree herein, in consideration of the payment by such new corporation to the Reading Company of \$5,600,000, and the agreement of the new corporation to issue and offer its shares to the stockholders of the Reading Company as hereinafter stated. The said new company will issue 1,400,000 shares of stock without par value and will offer the same to the stockholders of the Reading Company, preferred and common, share and share alike, for \$2.00 for each share of Reading stock. Provision shall be made for the disposition of any rights to subscribe which may not be availed of by the Reading stockholders, within a fixed period, to the end that the new corporation may receive the full purchase price of \$5,600,000.

The stock of the new corporation, in the first instance, is to be issued to a trustee appointed by the Court, who shall issue certificates of interest which the Reading Company shall offer for subscription to its stockholders, preferred and common, share and share alike; but provisions are made so that no person can actually acquire by purchase or otherwise the right to hold and enjoy the stock represented by such certificates without proof that he does not own any stock in the Reading Company and in making the purchase is not acting for or on behalf of any stockholder of said Company or in its interest (Rec., pp. 294, 304-307).

The Reading Company is then to merge with the Philadelphia and Reading Railway Company (all of whose stock it owns) under the authority of the present charter of the Reading Company (Rec., p. 193), so far as that Company is concerned and under authority of the Act of the Pennsylvania Legislature, hereinafter referred to (p. 28), so far as the Philadelphia and Reading Railroad is concerned, and subect the railway property to the direct lien of the General Mortgage. It will then accept the Pennsylvania Constitution of 1874 and will surrender all the powers it possesses under its present charter which are inappropriate to a railroad corporation of Pennsylvania. Thus the coal properties and business will be completely separated from the railroad properties and business, while the stockholders of the present Company, which owns both, will receive their appropriate pro rata share of each, safeguarded against future control of both in the same hands by the provisions above referred to.

There are various other provisions in the plan, but sufficient is here given for the consideration of the only question presented on these appeals.

The Appellants are respectively two Insurance Companies and a Committee representing certain shares of Common Stock of the Reading Company. They

objected in the District Court to so much of the plan as provided for the offer to the preferred and common stockholders of the Reading Company, share and share alike, of certificates of interest in the new corporation to which is to be transferred the interest of the Reading Company in the capital stock of the Philadelphia & Reading Coal & Iron Company, claiming that such offer in effect constitutes a distribution of accumulated net profits of the Reading Company to which the common stock alone is entitled. This contention having been denied by the District Court, they bring this appeal.

These Appellees are a Committee representing the holders of 89,611 shares of First Preferred Stock and 117,786 shares of Second Preferred Stock of Reading Company, who were permitted by the District Court to intervene and be heard in the protection of their interests (Rec., p. 131).

ARGUMENT.

I.

The sale of the beneficial interests in the Coal Company stock is a convenient method of accomplishing the required dissolution of an unlawful combination.

The sale by Reading Company to the new corporation of all its interests in the Coal & Iron Company for \$5,600,000 and the agreement to issue 1,400,000 shares of non-par stock and to offer the same pro rata to the preferred and common stockholders of Reading Company for \$2.00 per share of said company, is a convenient method of distribution to the Reading stockholders of whatever value there may be in the holdings of Reading Company in the Coal & Iron Company, over and above \$5,600,000, while insuring a disposition of that Company

free from any control by the Reading (Railroad) Company or its stockholders. It is an incident to the dissolution of the unlawful combination of the railroad and coal mining properties decreed by this Court.

The Appellants contend that the certificates of interest offered for sale are worth more than the price at which they are offered to the Reading stockholders and therefore that the company in effect is distributing a part of its surplus assets to and among its stockholders pro rata, whereas after the First and Second Preferred Stock has received 4 per cent. per annum, all surplus profits belong to the common stockholders.

II.

The distribution of interests in the stock of the Coal & Iron Company complained of is not a dividend of net profits of the Reading Company within the meaning of the contract between that Company and its shareholders, embodied in the stock certificates, and in respect of which the preferred stockholders are entitled and limited to 4 per cent. dividends, in preference and priority to any dividend to the common stock out of such net profits arising in any fiscal year.

On the contrary, the distribution is of the capital assets of the Reading Company, made pursuant to a decree of dissolution and in the liquidation of its affairs, in which liquidation all classes of stockholders are entitled to share alike without preference or priority of any one class over any other.

The holders of the preferred stock of the Reading Company are entitled to the same rights in the corporation as the common stockholders, save only insofar as respects the distribution of the net profits arising from

the business of the Company in any particular fiscal year, and in that the Second Preferred Stock might be converted, one-half into First Preferred and one-half into Common Stock, and in that all the preferred stock is subject to redemption at par, at the option of the corporation.

The Reading Company was created by special act of the Legislature of Pennsylvania, passed May 24, 1871 (Rec., p. 189), under the name of Excelsior Enterprise Company, which act conferred upon it the same rights, powers, privileges, franchises and immunities as had been conferred upon the Pennsylvania Company by the special act creating it and supplements thereto. By Section 4 of the Pennsylvania act, the corporation was empowered "to make from time to time dividends from the profits made by said Company."

Its capital stock was fixed at \$100,000, with the privilege of increasing the same by a vote of the holders of a majority of the stock present at any annual or special meeting, and it was provided that

"should the capital stock at any time be increased, the stockholders, at the time of such increase, shall be entitled to a *pro rata* share of such increase, upon the payment of the instalments thereon duly called for * * *" (Rec., p. 194).

It was further provided,

"That the capital stock of said company as authorized by said act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said company may from time to time determine; and the said company are hereby authorized and empowered to issue said stock, or any portion thereof, in payment of any debt or liability incurred in the purchase of any property, or they may sell or dispose of any portion of said common or preferred stock, on such terms and conditions as the Company may agree upon with any

party or parties, company or companies, or in the doing of any other act authorized by the provisions of the act to which this is a supplement." (Rec., pp. 194, 196.)

Pursuant to the authority so granted, in 1896, the capital stock of the Reading Company was increased from \$100,000 to \$140,000,000, divided into 2,800,000 shares of the par value of \$50 each of which \$28,000,000 should be first preferred, \$42,000,000 second preferred stock, and \$70,000,000 common stock (Rec., p. 78). It was further provided that the first preferred stock should be entitled to non-cumulative dividends

"at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, *in preference and priority to any payment in or for such fiscal year*, of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. *If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock*" (Rec., p. 82). (*Italics ours.*)

It was further provided that the consent of the holders of a majority of the whole amount of the first preferred stock then outstanding, given at a meeting of the stockholders called for that purpose, should be necessary to any increase of the authorized amount thereof, as well as to the creation of any mortgage additional to that for \$135,000,000, to be issued in accordance with the provisions of the reorganization plan,

“except that at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock;
* * *” (Rec., p. 83).

The Reading Company was also given the right at any time to redeem either or both classes of its preferred stock at par in cash, “if such redemption shall then be allowed by law.” The Reading Company further reserved the right at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the first preferred stock, to convert the second preferred stock, not exceeding \$42,000,000 at par, one-half into first preferred stock and one-half into common stock, and accordingly to so increase and issue its first preferred and common stock to provide for such conversion (Rec., pp. 78-81). Certificates were directed to be issued from time to time for such first preferred, second preferred and common stock, and the forms adopted are given in the record (pp. 82-87).

The Reading Company never did exercise either (a) the right reserved to convert the second preferred stock into one-half first preferred and one-half common, or (b) the right to redeem either or both classes of its preferred stock at par in cash. All of the stock, first pre-

ferred, second preferred and common (except an original issue of 1,000 shares for cash), as well as about \$56,000,000 of the General Mortgage Four Per Cent. Bonds, were issued in consideration of the transfer by the purchasers at the foreclosure sale in 1895, to the Reading Company, of all of the capital stock of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the bonds of the Philadelphia & Reading Railway Company for \$20,000,000, certain railway equipment and terminals, and stocks and bonds of other companies controlling certain railroads (Rec., p. 219). The Reading Company and the Philadelphia & Reading Coal & Iron Company jointly executed a mortgage to the Central Trust Company of New York, as Trustee, to secure their joint and several General Mortgage Four Per Cent. Bonds, authorized to be issued up to a total amount of \$135,000,000, of which \$50,369,000 were issued at once as part consideration for property conveyed pursuant to the plan of reorganization, and there was pledged as security for the said mortgage, among other things, the entire capital stock of the Philadelphia & Reading Coal & Iron Company and certain other stocks, bonds and other property.

III.

The relations between the holders of preferred stock and the Corporation is a contract relation and the extent of their right to share in the corporate profits and of their preference over the common stockholders, and in distribution of capital in liquidation, depends upon the terms of their contract.

See cases cited in 6 Fletcher Cyc. Corp., Section 3751.

Where, as in the instant case, neither the act of incorporation, nor the applicable laws, define the rights of the respective classes of shareholders, but merely authorize the corporation to issue preferred and common stock and to fix the terms and conditions which shall constitute the rights of the holders, the provisions of the certificates constitute the contract between the holders and the corporation, and their rights must be determined by such contract, read in the light of the established law of Pennsylvania.

As the Circuit Court of Appeals in the Second Circuit said in *Niles v. Ludlow Valve Co.*, 202 Fed., 141, 143, respecting a question as to the relative rights of preferred and common stockholders of a New Jersey corporation,

“It seems evident that the rights of the respective stockholders must be measured by the certificate of incorporation and the law of New Jersey in force when the defendant was organized.”

IV.

The holders of common stock in Reading Company have no right to exclude the preferred stock from sharing in the distribution of surplus earnings not distributed by the Board of Directors in any fiscal year, but carried to Profit and Loss, or Surplus Account.

Under the provisions of the stock certificates above quoted, the net earnings of the Company in each fiscal year are to be dealt with separate and distinct from those of previous years. No distribution by way of dividends can be made out of them to the common stock until a full 4 per cent. shall have been paid on the First and Second preferred stock. If there shall then remain any surplus net profits for such year, the Board of Directors "may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company" (Rec., p. 82). To the extent that there are no such surplus profits, or none which the Board of Directors, in the exercise of a sound discretion, conclude shall be distributed, the right of the common stockholders to share in the surplus profits of such year is at an end.

"So far as the holders of the common stock were concerned their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period."

Englander v. Osborne, 261 Pa. St., 366, 369.

In *Englander v. Osborne*, 261 Pa. St., 366, the certificates of preferred stock of a corporation entitled the holders to receive, when and as declared,

"a fixed yearly cumulative dividend of six per cent. payable quarterly, before any dividend shall be set apart on the common stock."

No dividends were paid by the Company upon their preferred or common stock during a period of nine years, after which a dividend of 54 per cent. covering the current year and all arrearages was declared and paid on the preferred stock, and, at the same time, a dividend of equal amount on the common. Plaintiff, a holder of preferred stock, sued to restrain the payment of the dividend to the common, claiming that such stock was not entitled to a dividend of more than 6 per cent. without sharing the excess equally with the preferred stockholders. In affirming a decree granting the injunction, the Supreme Court said:

"The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock. When a dividend is declared the former are entitled to first claim to the extent of their preference for the current year and if there remains a sum more than sufficient to pay a similar dividend on the common stock, both classes of stockholders are entitled to share equally in the excess. In the absence of agreement, express or implied, that dividends shall be cumulative, unpaid dividends in the past cannot be claimed: 10 Cye. 573.

"Likewise there is no logical reason for holding that common stockholders are entitled to go back of the current year, and claim to be reimbursed for unearned dividends in past years. To do so would render such dividends cumulative in effect without agreement. Accordingly, when during previous years no dividends were earned this was conclusive as to the right of all stockholders, both preferred and common, except for the contractual right of the former to payment out of future profits to the extent of their preference, before the latter would be entitled to participate in the earnings. So far as the holders of the common stock were concerned

their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period: *Dent v. London Tramways Co.*, 16 Ch. Div., 344, 353; Morawetz on Corporations (2nd Ed.), Sec. 459, cited in 10 Cyc, 573."

THE PREFERRED SHAREHOLDERS ARE ENTITLED TO ALL THE RIGHTS AND PRIVILEGES OF THE HOLDERS OF OTHER CLASSES OF STOCK, EXCEPT IN SO FAR AS THE CONTRACT EXPRESSLY OR BY NECESSARY IMPLICATION PROVIDES OTHERWISE.

In *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, 215 Pa. St., 610, preferred stock was issued by defendant Company under provisions of law whereby such stock

"was entitled to a preference over all other stock of said company in every future dividend of profits declared, until the holders were paid from the funds applicable to the payment of such dividend, ten per cent. per annum."

It was further enacted:

"that the holders of all the other stock of the company should not be entitled to participate in any future dividend profits of the company until the holders of preferred stock had been first paid from the funds applicable to such dividend ten per cent. per annum (pp. 611-612).

In three particular years, the preference stock was paid a 10 per cent. dividend, and a like dividend was paid on the common stock, and an extra dividend was also divided equally between the preferred and common. After a series of years in which no dividends were paid the preference shareholders, a dividend of 10 per cent. was declared on the preferred stock and a dividend of 1 per cent. on the common stock. Upon a bill filed by the holders of the preferred stock praying for a decree declar-

ing them entitled to cumulative dividends at the rate of 10 per cent. per annum, before the payment of any dividends to the holders of common stock, relief was granted in accordance with the prayer. The question considered in the Supreme Court was whether or not the preferred stockholders should be charged, as against the amount in arrears during certain particular years when no dividends or less than 10 per cent. dividends were paid, with the amount of dividends paid to them in excess of 10 per cent. during certain other years. On this point, the Court said:

"The preference created by the statute gave to the holders of the preferred stock, the right to receive \$5.00 per share per annum on each share of stock held by them, before the other stockholders were entitled to anything. That was the extent of the preference. If the funds applicable to a dividend amounted to just enough for that purpose the other stockholders took nothing. But when each class of stock had been paid ten per cent., they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors, nor was the amount paid to them in excess of ten per cent. in any year to be charged to them as an advance payment upon any future dividends that might be earned or divided in coming years. There was no preference shown in the distribution of these extra dividends. All the shareholders fared alike insofar as they were concerned. The preference created under the act of assembly went only so far as to give to the preferred stockholders a right to claim the first proceeds out of the fund applicable to dividends, to the extent of \$5.00 per share, per annum on their stock, and no farther. After that amount was paid, the common stockholders were entitled to participate, and did so participate, taking during the years when the extra dividends were paid, the same amount per share, as the preferred stockholders. So that the

extra payments during the years mentioned cannot be considered as overpayments to the holders of preferred stock. If the preferred stockholders had been limited, under the terms of the contract, to ten per cent per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound. But there is no such limitation in the act. The preferred stockholders stood upon the same plane as the others, with the additional advantage that they had the first right to partake in the distribution of profits up to the limit of \$5.00 per share per annum, and if necessary, the whole amount of the profits might be taken for that purpose, even if thereby the other stockholders were excluded."

In *Sternbergh v. Brock*, 225 Pa. St., 279, preferred stock was issued under a provision that it should receive a cumulative yearly dividend of 5 per cent., payable in each year, before any dividends should be set apart or paid on the common stock, and to be paid in full, both principal and accrued dividends, in the event of liquidation or dissolution of the Company before any amount should be paid to the holders of the common or general stock. From the organization of the Company until the year 1907, the holders of the preferred stock were paid the stipulated 5 per cent. annual dividend and no more, while all profits above the amount so paid were distributed by dividends to the common stockholders. In March, 1907, a quarterly dividend of 2 per cent. was declared by the Directors upon all stock, both preferred and common, which was at the rate of 8 per cent. per annum. Plaintiff, the holder of common stock, brought suit, claiming that the preferred stockholders were not entitled to receive more than 5 per cent. per annum on the par of their stock. An injunction to prevent such pay-

ment was denied, and this decree affirmed in the Supreme Court, where POTTER, J., said (p. 286):

"Where there is no stipulation in the contract to the contrary, the weight of authority clearly favors the right of preferred stockholders to share with the common stockholder in all profits distributed, after the latter have received an amount equal to the stipulated dividend on the preferred stock.

"In the absence of special provisions, the holders of preferred stock in a corporation are in precisely the same position, both with respect to the corporation itself and with respect to creditors of the corporation, as the holders of common stock, except only that they are entitled to receive dividends on their shares, to the extent guaranteed or agreed upon, before any dividends can be paid to the holders of common stock" 2 Clark and Marshall on Priv. Corp. (1901), Section 417-c." (Italics ours.)

In *Sterling v. Watson Co.*, 241 Pa. St., 105, the Court said:

"The certificate is a contract between the parties and means exactly what it says. The preferred stock is cumulative and the semi-annual dividends are given preference out of net earnings. These dividends being made payable out of the net earnings at stated periods must necessarily be understood as payments in cash at the dividend periods. Any other construction would be in disregard of the every-day experience of business men and would do violence to the common understanding of parties dealing in matters of this character. The dividend rate and the times of payment clearly indicate that the parties intended the preferred dividends to be paid in cash out of the net earnings and not in any other manner" (p. 110).

It was held in that case, that in exercising the right to retire preferred stock at par, reserved to the corpora-

tion in issuing the stock, the accumulated dividends at the specified rate must first be paid, and there could not be charged against the amount so due, the value of a stock dividend which had been declared by the corporation, a portion of which was distributed to the preferred stockholders. The Court held that the par value of such stock could not be regarded as a payment on account of the semi-annual dividends to which the preferred shareholders were entitled, and that there was nothing in the contract of the parties to warrant the payment of semi-annual dividends by the issue of new stock, and that, therefore, such dividends must be paid out of net earnings and not by stock.

V.

Capital assets acquired by the Corporation at the time of its organization, or by consolidation, or merger with other companies, do not constitute "net profits of the company" for "any particular fiscal year" with respect to which the preferred stockholders are entitled and restricted to a limited preference in dividends, within the meaning of the contract between the Reading Company and its stockholders.

In *Pardee v. Harwood Electric Co.*, 262 Pa., 68, an action by a preferred stockholder, to compel the payment of dividends, the certificate read as follows:

"The holders of the preferred stock shall be entitled to receive cumulative dividends at the rate of six per cent. per annum, which must be declared by the board of directors, when earned, to the extent of and only from the undivided net earnings of the Harwood Electric Company remaining after the payment of all operating expenses and fixed charges, in each and every fiscal year and which shall be in preference and priority to any payment in or for such fiscal year, of any dividend on other stock."

The company by merger with other companies had, at the time of its formation, a surplus of several hundred thousand dollars. The Court refused to direct the payment of dividends from the surplus, saying (p. 73):

"This surplus, which had existed from the time of the merger, could not be regarded as net earnings, or considered as such upon the question of dividends to the holders of preferred stock."

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And on page 74:

"The fact that certain balances are denominated in the books of a corporation as net earnings is, as against the corporation, persuasive but not conclusive evidence that they are such. In the absence of intervening rights, they are subject to explanation."

That the stockholders of the Reading Company acquired their stock with knowledge and understanding that the only disparity in right between the different classes of stock was respecting the distribution of net earnings, is demonstrated by the terms of the application made to the New York Stock Exchange for listing the stock of the Reading Company, in which it was said:

"The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets" (Rec., p. 181).

This is but the statement of a well settled rule of law.

Lloyd v. Penn. El. Vehicle Co., 75 N. J. Eq. 263.

In *North American Mining Company v. Clark*, 40 Pa. 432, the Court said:

"* * * the proprietors have made no express provision in their articles for winding up the concern, and therefore equity may define this process for them. But equality is equity, and we must adopt equality unless we have clear reason for doing otherwise, and we find none such. According to the express terms of the association, it seems to us that the new stockholders were to be at least equal sharers in the capital, and that they must have purchased on this supposition; and equity will not assume inequalities or preferences in such matters further than it finds them contracted for. The old stockholders have contracted for a preference out of the profit, but not out of the capital stock or basis of the operations of the company, and there is nothing revealed to us that satisfies that they ought to have it."

In *Lloyd v. Penn. El. Vehicle Co.*, 75 N. J. Eq., 263, a statute authorized the creation of two or more kinds of stock of such classes and with such designations, preferences and voting power or restriction or qualification thereof as might be stated in the certificate of incorporation, and a corporation organized thereunder provided that its preferred stock was "to receive and the company to pay a fixed yearly dividend of six per cent. before any dividend shall be set apart or paid on the general stock." Upon a winding up it was held that the preferred stockholders were entitled only to the preference set out in the certificate of incorporation and were not to be paid on account of the par value of their shares in preference to the common stockholders.

In *Guaranty Trust Co. v. Galveston City R. Co.*, 107 Fed., 311, at p. 318, the Circuit Court of Appeals for the Fifth Circuit, per TOULMIN, J., said:

"When a corporation is dissolved by consolidation with another, or becomes involved in debt and concludes to stop operations and pay its debts,

if there are any assets left after paying off the debts they are ordinarily distributed between the stockholders in proportion to the number of shares which each holds. There is no preference of one stockholder over other stockholders, except such preference is expressly contracted for. A preference as to capital stock or a distribution of net assets may be expressly contracted for."

In *Hamlin v. Toledo, St. Louis & Kansas City Railroad Co.*, 78 Fed., 664, 672, Mr. Justice LURTON, then Circuit Judge, said:

"Ordinarily preferred stock is entitled to no preference over other stock in relation to capital. But where there is an express agreement giving such a preference, not prohibited by local law nor the charter, we see no reason why it is not a valid contract, as between the corporation and such preferred stockholders, and binding upon the common stockholders."

This principle was quoted and applied in *Toledo, St. Louis & Kansas City R. Co. v. Continental Trust Co.*, 95 Fed., 497, 531—a case of dissolution by foreclosure and sale of entire corporate assets.

In *Roberts v. Roberts-Wicks Company*, 184 N. Y., 257, a corporation, because of an impairment of its capital, reduced its capital stock and as a result of the reduction there was a balance or surplus. The directors proceeded to devote this surplus to the payment of dividends and arrears thereof on its preferred stock. The certificate provided that the owners were entitled to an annual dividend of 6 per cent. payable out of the surplus profits of the Company before any dividend was payable on the common stock; that such dividend was cumulative and in case of non-payment should bear interest at the rate of 6 per cent. from the date when payable; that all remaining surplus profits of the company should belong

to the common stock and that in all other respects the preferred and common stock were alike. It was held that such surplus so resulting could not be devoted to the payment of dividends and arrears on the preferred stock, since dividends were payable out of net profits and the fund resulting from a reduction of the capital stock did not consist of profits, but of capital which belonged to all of the shareholders in proportion to their holdings. Judge GRAY said (p. 266):

"That which constitutes the capital stock of a corporation belongs to all of its stockholders, proportionately to their holdings. It is divided into shares and each share represents the holder's proportionate interest. (*Jermain v. L. S. & M. S. R. Co.*, 91 N. Y., 492.) Upon dissolution, or in liquidation, it entitles him to share ratably in the assets. If the directors had undertaken to divide this surplus of capital, it was apportionable, only, among all the stockholders ratably. * * *

But, assuming that the directors in their discretionary management of the company's affairs, concluded, and were empowered, to distribute this surplus of capital, the preferred stockholders would have no legal, or equitable, claim upon it in satisfaction of past due and unpaid dividends. That was not the contract. Their only right would be to share in such a distribution ratably with the common stockholders. (*Strong v. Brooklyn C. T. R. R. Co.*, 93 N. Y., at p. 435.) The charter and the contract made them alike in all respects except as to dividends. * * *

In the present case, it must be borne in mind that the \$9,138.15 remained in the corporate accounts, after the reduction of capital stock, as a portion of the former capital and it was, in no sense, like an excess of property, which had been accumulated in the conduct of the business beyond the fixed capital. It did not represent 'surplus profits arising from the business'; it was not within the intendment of the agreement with respect to dividends on the preferred stock

and its distribution, when made, could only be legally effected by dividing it among all the stock holders ratably and without preference."

In *In re Accrington Corporation Steam Tramways Co.*, 1909, 2 Chancery, 40, the question for determination was whether in the distribution of the company's assets, the preference shares, or any of them, were entitled to priority as to capital or income. Upon a sale of assets it appeared there was a deficiency of capital of some £11,250. The profit and loss account showed a balance of £2,687. At the last meeting prior to liquidation a dividend of 6 per cent. was declared on all shares and a balance of £1,186 was carried forward, this being subsequently increased by £480 when the company was wound up and a liquidator appointed. Upon one class of preference stock having a "cumulative preference dividend of 6 per cent. per annum, but without any priority as to capital" there were 13 per cent. dividends in arrears. These shareholders claimed a preference against this £1,186 balance to make up the arrears. The Court held that as no further dividends had been declared out of undistributed profits subsequent to liquidation, the preference holders were not entitled to undistributed profits in respect of dividends and "since the Companies Clauses Acts give them no priority as to capital, the assets must be distributed ratably among all the shareholders of the company in proportion to their capital."

See, also, *Re Ramel Syndicate, Ltd.*, 1911, 1 Ch., 749.

In *In re Frazier & Chalmers, Ltd.*, 1919, 2 Ch., 114, 88 L. J. (Ch.) N. S., 343, it was held that where a resolution creating preference shares defined the rights to all the profits, but with regard to capital on a winding up or dissolution, merely gave preference shareholders a right to be repaid their capital before the ordinary shareholders.

ers were repaid and was silent as to any assets which might remain after all the capital was repaid, such assets must be ratably distributed between ordinary and preference shareholders. In commenting on *In re Espuela Land and Cattle Co.*, 1909, 2 Ch., 187, and *Will v. United Lankat Plantations, Ltd.*, 1914, App. Cas., 11, the Court said:

"None of the opinions of the Law Lords [in the Will case] suggest that a preferential right to be repaid capital in a winding up is exhaustive like the dividend provision, and operates to deprive the shareholders having such preference of the right to more than a sum fixed by the face value of their shares, if there is in fact a surplus, after repayment of capital. * * *

"Speaking for myself, I think SWINFEN EADY, J. [in the Espuela case] intended and rightly, to lay down that in the absence of provision to the contrary the shareholders' rights are equal."

See especially p. 348 of the opinion (88 L. J. Ch. N. S.).

In *In re Bridgewater Navigation Co.*, L. R., 39 Ch., Div. 1; 14 App. Cas., 525, there was a fund upon dissolution of a corporation sufficient to pay the debts and the amount invested by the preferred and common stockholders, and to leave a large surplus over. The preferred stock had been fully paid up to the extent of ten pounds per share. The common stock had been paid for only to the extent of three pounds ten shillings per ten pound share. It was held in the Court of the first instance and in the Court of Appeal, that after paying to each preferred stockholders ten pounds per share and to each common stockholder three pounds ten shillings per share, the surplus should be divided among all the stockholders, preferred and common, in proportion to the amount of money actually contributed by each. The common stockholders insisted that the whole of this surplus was profits, and that as they were entitled to all of the profits after paying the 5 per cent. to the pre-

ferred stockholders, they were entitled to the whole of the fund. The Court, however, held that this was untenable, and that the rule contended for by the common stockholders applied only to the annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect, the decree was affirmed by the House of Lords; but it was there held that the surplus should be divided among the stockholders in proportion to the number of shares held by each, and not in proportion to the amount contributed by each.

VI.

The Plan contemplates not only such a distribution of the capital assets of the Reading Company as will comply with the requirements of this Court and terminate the unlawful combination found by it to exist, but the termination of the corporate life of the Reading Company and the creation of new corporations henceforth separately to control (a) the Coal properties and (b) the Railroad properties.

While the Plan provides that the Reading Company will merge with the Philadelphia & Reading Railway Company

“under the authority contained in the present charter of the Reading Company, * * *

the statute governing the merger of the Philadelphia & Reading Railway Company into the Reading Company, is an Act of the Pennsylvania Legislature approved May 3, 1909 (P. L., 408), authorizing one corporation

“to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of

this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *

When the Reading Company is merged with the Railway Company it will lose its identity (*Lauman v. The Lebanon Valley Railroad Company*, 30 Pa., 42, 45). In this case the Court said:

"* * * such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved."

The act of 1909 provides the machinery of the merger, including a joint agreement by the Directors of each corporation, its submission to the stockholders of the respective Companies, and the filing of a certificate as to the vote at such meeting in the office of the Secretary of State of the Commonwealth,

"who shall forthwith present the same to the Governor for his approval, and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation."

Upon the filing of such certificate and agreement in the office of the Secretary of State,

"and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement, possessing all the rights, privileges and franchises theretofore vested in each of them, and all the estate and property, real and personal, and rights of action of each of said corporations, shall be deemed and taken to be

transferred to and vested in the said new corporation without any further act or deed: * * * But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent * * *."

This statute was construed in the case of *Pennsylvania Utilities Co. v. Public Service Commission*, 69 Pa. Super. Ct., 612, 618, where it was expressly held that a merger under it had the effect of destroying the corporate identity of all merging companies, the Court saying:

"It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result."

The result of the Plan, therefore, is the dissolution of the existing Reading Company. On such dissolution all classes are entitled to share equally in the assets, no matter how the latter are distributed. The assets go in two directions: first, the coal assets to the new coal company; second, the railroad equipment, terminals and other assets, to the (new) Reading Company by merger. It is not clear under the Plan, whether or not new certificates of stock of the merged company will be issued in exchange for the certificates of stock of the Reading Company, but

in any event, an equality of distribution between the stockholders is brought about in respect of the assets acquired by the merged company, because the stockholders will have the same *pro rata* stock holdings after the merger as before.

The judges in the District Court pointed out that the holding by the Reading Company of the stock of the Coal & Iron Company was decreed by this Court to be unlawful, and was required to be disposed of so as to establish the independence of the companies from each other; and that such disposition was made by the Plan.

"From these considerations, it is apparent that whatever this disposition of the stock" (*i. e.*, of the Philadelphia & Reading Coal & Iron Company) "may be called, it is in no sense an earning of the Reading Company which is to be disposed of by that company as a dividend. It is a taking by the law of an asset of that company, a stock asset, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself. Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings" *per* BUFFINGTON, Cir. J. (Rec., pp. 281-282).

The observations made by this Court in *Harriman v. Northern Securities Co.*, 197 U. S., 244, with reference to the method adopted by the Northern Securities Company to terminate the unlawful combine of competing lines of railroad, found by this Court to exist, are pertin-

ent to the case at bar. Mr. Chief Justice FULLER in delivering the opinion of the Court said (p. 299):

"Doubtless it became the duty of the Securities Company to end a situation that had been adjudged unlawful, and this could be effected by sale and distribution in cash, or by distribution in kind, and the latter method was adopted, and wisely adopted, as we think, for the forced sale of several hundred millions of stock would have manifestly involved disastrous results."

VII.

The decisions cited by the Appellants respecting the distribution of net profits of a company arising in the ordinary course of business have no application to the case at bar. The Corporation is not distributing surplus net earnings, it is segregating its capital and business in compliance with the decree of this Court.

It was organized to control the business of coal mining and that of railroad transportation. This Court has held such to be an unlawful purpose. Therefore it is dividing and distributing its properties so as to end that unlawful status, and in the Plan to accomplish such purpose it is mindful of the interests of its stockholders who are equally entitled to share in its capital, without preference or priority.

Appellants Continental Insurance Company, *et al.*, argue that the mandate of this Court

"does not require the Coal Company's stock to be distributed to Reading Company preferred stockholders. Disposition of the stock of the Coal Company is directed, but the mandate leaves undisturbed the respective rights of classes of stockholders" (p. 36).

This is begging the question. As Judge BUFFINGTON pointed out in the District Court:

"It will be noted that this stock holding by the Reading Company in the Coal Company was decreed by the Supreme Court an unlawful holding, and was one as to which the Supreme Court directed this Court to enter a decree 'with such provision for the disposition of the shares of stock and bonds and other properties of the various companies, held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company,' etc." (Rec., p. 280).

The whole gravamen of Appellants' argument is that the distribution of the stocks is a voluntary dividend by the Reading Company. The fact is, that it is a compulsory distribution, made pursuant to the decree of this Court for the purpose of ending an unlawful combination found to exist by reason of the control exercised by the Reading Company over the coal business and the railroad business. The cases cited by Appellants to sustain their argument that, being a dividend, the property must go to the common stockholders, are wholly irrelevant to the present issue, being decisions where accumulated net profits arising from the corporate business were under distribution by way of dividend to the stockholders. See *Stone v. U. S. Envelope Co.*, 119 Maine, 394; *Russell v. American Gas & Electric Co.*, 152 App. Div. (N. Y.), 136.

In the *Stone* case, the Supreme Court of Maine pointed out the difference in the rule established by the courts in Pennsylvania and the courts in certain other States, and, referring to the latter, adopted a rule avowedly at variance with the Pennsylvania rule. In addition to that, the language of the preferences in each

of those cases was quite different from that in the Reading case. The same observation may be made regarding the recent decision by the United States Supreme Court in *Rockefeller v. United States*, and *New York Trust Co. v. Edwards*, 42 Sup. Ct., 68. Those cases concerned voluntary distributions of shares of stock of corporations unaffected by provisions similar to those of the Reading stock.

The Appellants, Continental Insurance Company, *et al.*, say:

“The limitation of the preferred stock to a realization of its par value was from the very beginning regarded, not merely as a limitation on the preferred stock, but as an asset of the common stock” (Brief, p. 44).

Precisely the contrary is the fact. There is no such limitation, as was pointed out in the foregoing points. Not only does the only limitation upon the participation of preferred stockholders in the property of the corporation affect merely the “net profits” of each particular fiscal year, but in the application made in 1904 to list the preferred stock of the Reading Company on the New York Stock Exchange, the following was stated:

“The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets” (Rec., p. 181).

This was the clear and the correct interpretation put by the officers of the corporation upon the rights of the stockholders before any controversy arose, and upon which all subsequent trading in those stocks must have been conducted. The so-called “practical construction by the interested parties,” referred to by Appellants Continental Insurance Company, *et al.* (Brief, p. 45), has reference merely to the fact that dividends on common

stock were for a few years declared and paid in excess of those paid on the preferred stocks. The fact that the corporation reserved the right to redeem the preferred stock for cash at par, has no bearing whatever upon the unrestricted right of the preferred stock to share equally with the common stock in the distribution of assets in liquidation, any more than the right reserved to the stockholders in the charter of the corporation to a *pro rata* share of the capital stock (irrespective of classes) in case it should at any time be increased (Rec., p. 194) determines the right of the preferred stockholders to share *pro rata* with the common stockholders in the distribution of income. The cases cited in the brief of Continental Insurance Company, *et al.* (pp. 46 to 54), upon the construction of the stock certificates, all turn upon different language from that employed in the certificates of the Reading Company. Not only may the Pennsylvania cases

“be taken as *favoring* the principle that in the absence of any words of limitation in the certificates, when earnings are in excess of the amount of the dividend to the preferred shareholders, the common stockholders thereafter are entitled to a like dividend, and thereafter both preferred and common stockholders are entitled to the excess ratably,” (italics ours)

as admitted by Appellants (Continental Ins. Co. Brief, p. 55), but they *establish* that principle, and were it not for the acquiescence of the preferred stockholders in the distribution of dividends to the common stock for several years in excess of those paid the preferred stockholders, these Appellees would feel compelled to urge that as applicable to the present case. It is not the fact, as contended by the Appellants, that the words “preferred stock” have a generally accepted commercial meaning. On the contrary, it has been pointed out in cases too numberless to

require or justify citation that the rights of the holder of preferred stock depend upon the particular contract under which it is issued, and in the face of the special language of the Reading Company certificates and the unbroken line of decisions construing the rights of preferred stockholders in the Supreme Court of Pennsylvania, it is worse than futile to go afield to seek construction based upon different language or under rules adopted by the Courts in other States.

The distribution in the present instance, as above pointed out, is a distribution of capital pursuant to the decree of this Court. The provisions of the Pennsylvania law cited by appellants, Continental Insurance Company at page 76 of their brief, are applicable to ordinary dividends of net profits made from time to time, and those dividends are so limited by the statute that they

"shall in no case exceed the amount of the net proceeds actually acquired by the company,"

to the end that

"the capital stock shall never be impaired thereby.

These provisions are applicable to the distribution of profits by a going concern in the ordinary course of business. They can have no application to the dissolution of an unlawful combine and the enforced distribution of its capital assets under circumstances similar to those in the present case. Nor can it be successfully contended, as Appellants endeavor, that the transaction in the stock of the Coal & Iron Company is not a sale. As already pointed out, the stock of the Coal & Iron Company itself is not sold, but certificates of beneficial interest are sold in the first instance, to the stockholders of the Reading Company, with such restrictions, that before full ownership can be enjoyed, they must be acquired by someone not interested in the stock of the reconstructed Reading

Company, which is to be a railroad corporation pure and simple.

The utmost possible contention of the appellants is that those rights have a value in excess of the price at which they are offered for sale to the Reading stockholders, and that, therefore, insofar as the difference between the actual market value and the subscription price is concerned, it amounts to a distribution of property of the Reading Company. That property Appellants contend, is a part of the surplus accumulated net profits of the Reading Company, and they seek to apply the rule applicable to the distribution of net profits in the ordinary course of business to that situation. The answer to this proposition appears to us to be two-fold: first, that the transaction is not an ordinary distribution of net profits, but a disposition of capital assets, a segregation of properties to conform with the requirements of this Court; and secondly, that even if a portion of the property distributed is accumulated net profits which have been carried to surplus account, the common stockholders are not entitled to share in the same to the exclusion of the preferred stock, being limited in dividends to the net profits of a particular year, with respect of which full payments shall have been made on the first and second preferred stock.

The observation of Judge BUFFINGTON in his opinion in the District Court, is apposite:

“* * * it will be noted that the mandate directs a ‘disposition of shares of stock and bonds and other property held by the Reading Company,’ and in that respect the mandate has been complied with precisely, in that there has been a ‘*disposition*’ of the stock, it being taken from the Reading Company, and it has not even been distributed by that Company, but, treating it as an unlawful holding of that Company, it is to be taken by the Court and disposed of absolutely by it, by sale through the

agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it" (Rec., p. 281). (*Italics ours.*)

It is submitted that the method adopted by the District Court to meet the requirements of the decision in this Court is proper, and that no such inequitable division as is contended for by the common stockholders' plans can be approved by this Court.

The language of the opinion of the District Court so well sums up the position of these appellees, that we are content to rest our case on its reasoning.

Circuit Judge BUFFINGTON said:

"Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. We are therefore of opinion that the plan which embodies these equitable principles should be approved and that the claim of the common shareholders to take all of this stock to the exclusion of the preferred stockholders should be denied. And in approving such plan we note that in point of fact the equity of a common participation of all stockholders, preferred and common, has not only the approval of the Government of the United States that has no interest in the controversy, save to see that equity is done to all; of the Reading Company which has no interest save an impartial stewardship for all its shareholders; and lastly the silently expressed approval of sub-

stantially two-thirds of the shares held by common stockholders. This significant and impressive fact cannot but be regarded as highly persuasive of the substantial equity of this Plan" (Rec., p. 282).

It is therefore respectfully submitted that the decree should be affirmed.

CADWALADER, WICKERSHAM & TAFT,
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First and Second Preferred Stock-
holders, Appellees.*

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,
of Counsel.



Nos. 609 & 610.

OCTOBER TERM, 1921,
U. S. SUPREME COURT, U. S.

FILED

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IN THE
Supreme Court of the United States

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY
OF NEW YORK, Appellants,

VS.

READING COMPANY, ET AL., Appellees.

SEWARD PROSSER, ET AL., Appellants,

VS.

READING COMPANY, ET AL., Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR JOSEPH E. WIDENER, APPELLEE.

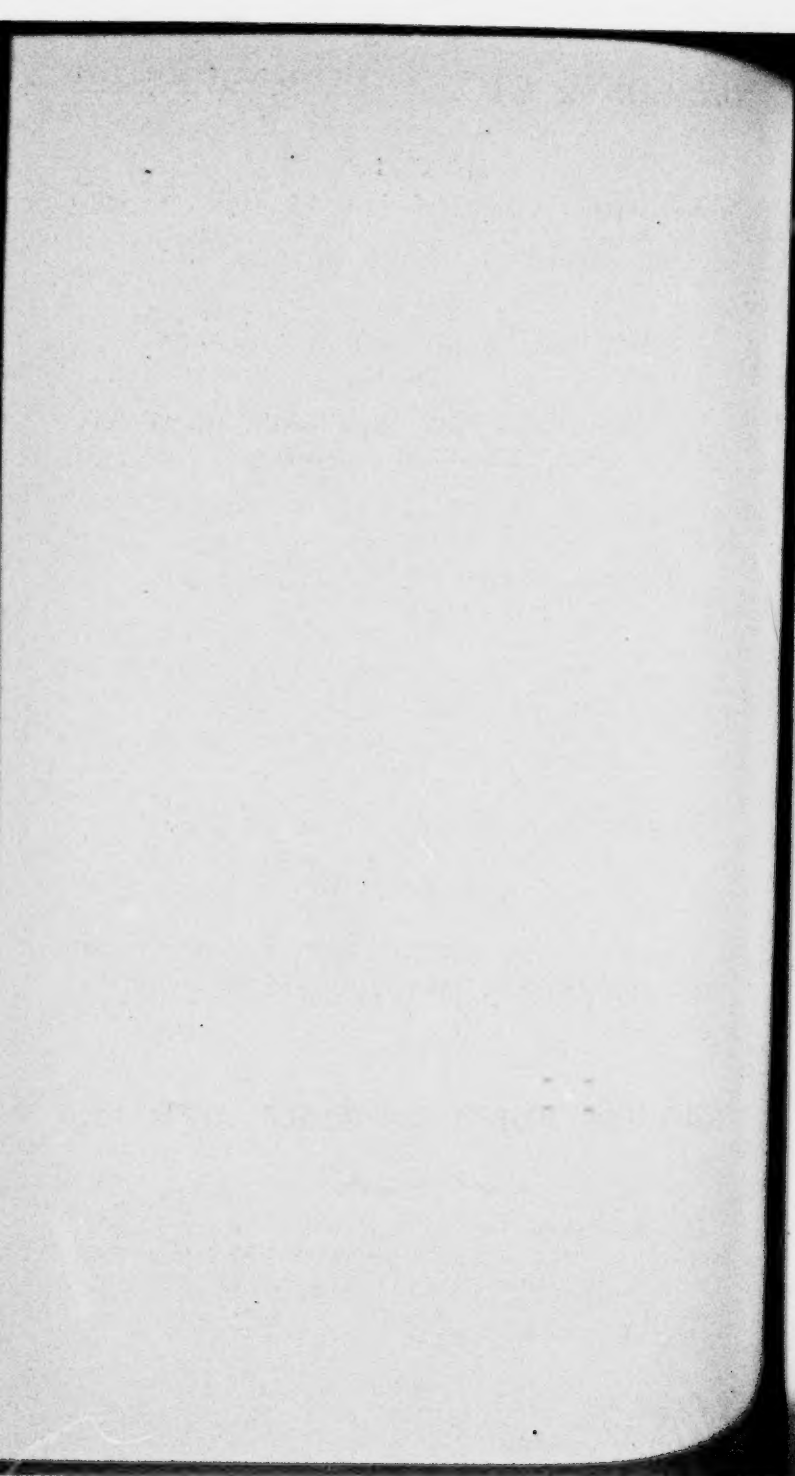
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ALLEN, LANE & SCOTT, PRES., PHILADELPHIA.



In the Supreme Court of the United States.

OCTOBER TERM, 1921. NOS. 609 AND 610.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, Appellants,

vs.

Reading Company, et al., Appellees.

Seward Prosser, et al., a Committee, &c., Appellants,

vs.

Reading Company, et al., Appellees.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

ARGUMENT FOR JOSEPH E. WIDENER,
APPELLEE.

A COMMON STOCKHOLDER.

This appellee has the largest individual interest in this controversy. He is trustee of the estate of his father—the late P. A. B. Widener—which owns 100,000 shares of

Reading common stock, a one-fourteenth part of the whole issue. Appellee is a beneficiary to the extent of 50 per cent. in the estate and also has a considerable holding of common stock in his own name. Neither appellee nor the Widener estate owns any preferred stock. Appellee is also a director of the Reading Company.

Appellee gives this plan his hearty and unqualified approval.

The problem under the mandate of this Court was to devise a plan which would

1. Effectually dissolve the illegal combination.
2. If possible impinge on no legal rights of the parties interested.
3. Do substantial justice to all interests.

This plan meets these three requirements.

I. IT ACCOMPLISHES THE DISSOLUTION OF THE ILLEGAL COMBINATION.

No exception has been taken to the plan as not fully meeting the mandate of this Court. It effectually dissolves the illegal combination of coal mining and transportation business, and it destroys the agency (the special charter of the Reading Company) which made the illegal combination possible.

II. IT IMPINGES ON NO LEGAL RIGHTS.

It was devised with this object in view and it accomplishes that object.

(a) There is a most elaborate and seemingly complicated interstockholder contract in The Reading Company, but it deals with but one problem—the distribution of current earnings. With respect to these the preferred stock is preferred and limited to four per cent. All of the rest that the directors distribute must go to the common stock, and for the past ten years with the different classes of stockholders

ably represented on the Board there has been no difficulty or difference of opinion as to how to apply this arrangement. The preferred stocks in each year have received four per cent. and no more, and all the rest of the earnings distributed as dividends—six per cent., seven per cent. and eight per cent.—has been paid to the common stockholders.

(b) There is to be found in this interstockholder contract no affirmative word as to distribution of accumulated surplus. There is a proviso from which inference may be drawn that it may be distributed (except in certain cases) to the common stockholders alone,—or the clause may be given a meaning consistent with the theory of the preferred stockholder—that earnings not currently distributed become a permanent fund for the greater safety of the limited preferred dividend:—that such accumulated profits become capital assets—whatever that may be—and can never become the property of the stockholders except in liquidation. These two views are most ably presented in the brief filed on behalf of the common stockholders, appellants, and the preferred stockholders.

This appellee presents no argument on this point. One of the great merits of this plan is that it does not raise this question but leaves the rights of the parties exactly where it finds them.

(c) The contract is silent as to distribution in liquidation. Therefore under the law, particularly the Pennsylvania law, all shareholders share equally. This proposition is admitted by all parties and need not be elaborated.

Now the whole argument of the appellants consists, first, in setting up that the distribution of valuable rights—*compelled by decree of the court and not through the untrammelled exercise of discretion by directors—is a dividend*—in the customary meaning of the word.

Even if appellants establish this position they do not sustain their appeals, for the interstockholder contract deals only with dividends from current earnings and possibly from accumulated surplus. And this coal property illegally acquired in 1896 is certainly neither.

Either this transaction is a resale to the original vendors (the preferred and common stockholders as an unsegregated group) of this coal property—or it is a partial liquidation of capital assets upon dissolution of The Reading Company. For the Reading Company is dissolved under the plan. It is merged with the Railway Company. That merger so far as the railway company is concerned must be under the Pennsylvania Act of 1909, which definitely provides for the erection of a new company in place of the old.

While the dissolution is complete the *liquidation* is only *partial*, and the present arrangement between stockholders is continued as to profits arising from operation of the railroad.

This brings us to the third point of this argument.

III. THE ARRANGEMENT IS FAIR.

(a) Let us look at the results accomplished. It is true the preferred stockholder is getting something of substantial value. But had he insisted on his extreme rights, had he refused to permit his capital to continue in the curtailed enterprise at a return entirely inadequate in the present money market, he could have forced complete liquidation as well as complete dissolution, and have shared equally with the common stock in distribution. The danger to the common stockholder in the present emergency is that, should he be successful in his appeal, this is exactly what will happen, for the merger can only take place if it commands a majority vote of the stock and it cannot command that majority unless the preferred stock shares in the rights.

(b) This appellee most sincerely believes that even if the preferred stockholder gets under the plan something that he is not legally entitled to, he is giving up more than he is getting.

If the common stock is giving up something, it is getting in return the use of \$70,000,000 of preferred stockholders' money at a limited return of four per cent., non-cumulative. All further earnings from the use of this money in the railroad business accrue to the common stockholder.

How foolish for the common stockholder to jeopardize this arrangement by insistence upon doubtful legal rights, the establishment of which would drive the company to complete liquidation.

(c) As an alternative, the coal property might be offered to outside and independent parties, but no proposal has come from such, and the present plan accomplishes the same result by a sale at retail through stockholders and at a profit which the stockholders might not otherwise secure.

(d) As another possible alternative, the company might elect to eliminate the preferred stock, but this requires the raising of either \$49,000,000 or \$70,000,000 in this money market with which to retire a four per cent. obligation—a very expensive proceeding.

(e) The appellants have chosen this forum in which to be heard, although the question is in no sense a federal one. They will therefore be bound by the decision of this court and cannot again raise the same questions in the state courts—and so further delay the winding up of this illegal combination. But if any stockholder not having assented to this plan feels aggrieved at the terms of the merger under which the railroad enterprise alone is hereafter to be carried on, the law of Pennsylvania permits him to withdraw his interest in cash as that interest may be determined by a jury.

IN CONCLUSION.

The plan submitted overcomes the serious difficulties of attempting to sell so large a property to a single purchaser or syndicate in the present market. It avoids the necessity of refinancing an issue of \$49,000,000 or \$70,000,000 of four per cent. money. It dissolves the agency which made the illegal combination possible while preserving the goodwill and organization of the Railroad property and the inter-stockholder relationship with respect to division of profits. The plan has received the approval of the Department of Justice and of the District Court; the approval of the bondholders and preferred stockholders; the approval

of the Reading Company acting through its duly constituted board of directors. The only dissent comes from a minority—and a minority only—of the common stock, and it is perfectly apparent that if this interest succeeds in its present appeal, it will be to its own loss and discomfiture.

ELLIS AMES BALLARD,
For Joseph E. Widener, Appellee.

BALLARD, SPAHR, ANDREWS & MADEIRA,
Of Counsel.

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IN THE

SUPREME COURT of the UNITED STATES.

OCTOBER TERM, 1921.

No. 609.

CONTINENTAL INSURANCE COMPANY and
FIDELITY-PHENIX FIRE INSURANCE COM-
PANY OF NEW YORK,

Appellants,

—against—

READING COMPANY and Others,

Appellees.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCKNER and
JOHN H. MASON, as a Committee, etc.,

Appellants,

—against—

READING COMPANY and Others,

Appellees.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR READING COMPANY.

CHARLES HEEBNER,
R. C. LEFFINGWELL,
WM. CLARKE MASON,
L. D. ADKINS,
A. I. HENDERSON,

Of Counsel

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IN THE
Supreme Court of the United States.

OCTOBER TERM, 1921.

No. 609.

CONTINENTAL INSURANCE COMPANY and FIDELITY-
PHENIX FIRE INSURANCE COMPANY OF NEW
YORK,

Appellants,

—against—

READING COMPANY and others,

Appellees.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCKNER and
JOHN H. MASON, as a Committee, etc.,

Appellants,

—against—

READING COMPANY and others,

Appellees.

APPEALS FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE EASTERN DISTRICT OF
PENNSYLVANIA.

BRIEF FOR READING COMPANY.

The statements of the case and of the facts in
the briefs for appellants contain much which in-
vites controversy. Believing, however, that such

controversy would be irrelevant to the legal question presented by these appeals, the following summary statement is made, in lieu of a detailed analysis of the statements contained in the briefs for the appellants, in the effort to present briefly the facts deemed necessary to an understanding of the issue.

SUMMARY STATEMENT.

The Government's Dissolution Suit

This cause originated as a proceeding brought by the Government of the United States to dissolve the intercorporate relations existing between the corporate defendants on the ground that such relations constituted a violation of the Sherman Anti-Trust Act (26 Stat. 209), and also of the commodities clause of the Act of Congress of June 29, 1906 (34 Stat. 584, 585) (Record, p. 2).

The Decision of This Court

On April 26, 1920, this Court handed down an opinion in which this Court among other things directed the District Court to enter a decree (Record, p. 25)

"dissolving the combination of the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire

independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh and Wilkes-Barre Coal Company, held by the Central Railroad Company of New Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all of these now combined companies may be conducted in harmony with the law." *United States v. Reading Company*, 253 U. S. 26 (Record, pp. 1-26).

The Interlocutory Decree of the District Court

The Mandate of this Court was filed in the District Court on August 13, 1920 (Record, p. 27), and thereafter on October 8, 1920, the District Court entered a Decree on Mandate (Record, p. 31), which among other things ordered that

"the defendants shall submit to this Court a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal

and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law."

Accordingly on February 14, 1921, a plan was filed by the Reading Company, the Philadelphia and Reading Railway Company (hereinafter called the Railway Company) and The Philadelphia and Reading Coal and Iron Company (hereinafter called the Coal Company) (Record, p. 40). That Plan was approved by the then Attorney General of the United States, except as to the disposition to be made of the stock of The Central Railroad Company of New Jersey (Record, p. 45).

The board of directors had approached the formulation of the Plan from the point of view, first, of obeying the Mandate of this Court; second, of avoiding as far as possible the disturbance of existing securities; and third, of doing justice between existing classes of security holders (Record, p. 154).

Promptly after filing the Plan the Reading Company sent a copy to each of its stockholders with a letter dated February 14, 1921, summarizing it (Record, pp. 156, 186). Stockholders and holders of bonds issued under the General Mortgage of the Reading Company and the Coal Company, were permitted to intervene, and the Trustee under said General Mortgage was made a party defendant (Record, p. 203). The Reading Company and its board welcomed the intervention of all stockholders as tending to relieve them of the sole responsibility in a matter which was evidently controversial (Record, p. 154).

The stockholders who filed petitions to intervene are as follows:

<i>For the Plan</i>	Number of Shares	
	Preferred	Common
New York Central Railroad Company (Record, p. 140) .	406,600	197,050
The Baltimore and Ohio Railroad Company (Record, p. 142)	406,600	200,050
Madge Fulton Kurtz (Record, p. 208)	1,000	
William B. Kurtz (Record, p. 208)	8,650	
Iselin Committee (Record, p. 209)	226,333	
Joseph E. Widener (Record, p. 209)		101,900
Total	1,049,183	499,000
<i>Against the Plan</i>		
Prosser Committee (Record, p. 208)		407,728
The Insurance Companies (Record, p. 208)		8,400
Total		416,128

A petition to intervene was filed by Girard Avenue Title and Trust Company stating that it owned 900 shares of common stock. It has not, however, joined in the appeal and the petition does not give an indication of its attitude toward the Plan (Record, p. 145).

A petition for information was filed by Frances T. Ingraham owning common stock (Record, p. 120).

The capital stock of the Reading Company

amounts to \$140,000,000, divided into 2,800,000 shares of the par value of \$50 each, of which \$70,000,000 is common stock and \$70,000,000 is 4% non-cumulative preferred stock. Of the latter \$28,000,000 is first preferred and \$42,000,000 second preferred (Record, p. 157).

Seward Prosser, Mortimer N. Buckner and John H. Mason as a Committee, etc., appellants, are in the above table and hereinafter referred to as the Prosser Committee.

Adrian Iselin, Robert B. Dodson, Edwin G. Merrill and William A. Law as a Committee, etc., appellees, are in the above table referred to as the Iselin Committee.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, appellants, are in the above table and hereinafter referred to as the Insurance Companies.

By order filed April 12, 1921 (Record, pp. 205-207), the District Court set down for argument on May 2, 1921, a number of questions, two of which, raised by the Trustee under the General Mortgage and the bondholders, were eliminated by modifications of the Plan (Record, p. 210) and one of which is the question involved in these appeals. *i. e.*, whether paragraph five of the Modified Plan (Record, p. 275), "confers upon any one class of stockholders of the Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders." After the argument a Modified Plan was filed on May 12, 1921 (Record, p. 274).

Summary of Modified Plan

The Modified Plan may be summarized as follows:

(a) *The Philadelphia and Reading Coal and Iron Company.* The Reading Company will as-

sume the \$96,524,000 General Mortgage 4% Bonds which are the joint obligation of the Reading Company and the Coal Company, will receive from the Coal Company \$10,000,000 in cash or cash assets and \$25,000,000 in 4% Mortgage Bonds of the Coal Company, and will exchange general releases with the Coal Company (Record, p. 274). The Reading Company owns all the stock (par value \$8,000,000) of the Coal Company, subject to the lien of the General Mortgage (Record, p. 157). The Reading Company will, subject to the lien of the General Mortgage, sell its interest in the stock of the Coal Company for \$5,600,000 to a new corporation created by the Court's order (Record, p. 275), of which the Court will retain control so as to prevent its being used to thwart the decree (Record, p. 284; *United States v. E. I. Du Pont de Nemours & Company*, 273 Fed. Rep. 869). Assignable certificates of interest in the stock of the new corporation, exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company, will be offered for sale to the stockholders of the Reading Company, preferred and common, share and share alike for \$5,600,000 or \$2 for each share of Reading stock (Record, p. 275).

(b) *The Philadelphia and Reading Railway Company.* The Reading Company owns all the stock (par value \$42,481,700) of the Railway Company, subject to the lien of the General Mortgage (Record, p. 157). The Reading Company will merge the Railway Company and will subject the railway property to the direct lien of the General Mortgage, will accept the Pennsylvania Constitution of 1874 and proceed under the Pennsylvania Act of 1856 to surrender

those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier and the relation of the Reading Company as a specially chartered holding company to the Railway Company will be terminated (Record, pp. 276-277).

(c) *The Central Railroad Company of New Jersey.* The Reading Company owned stock of The Central Railroad Company of New Jersey to the par amount of \$14,504,000, constituting more than a majority of its stock, subject to the pledge thereof under the Jersey Central Collateral Trust Mortgage securing bonds to the amount of \$23,000,000 (Record, p. 158). The Reading Company was directed to transfer to Trustees appointed by the District Court, subject to the lien of the Jersey Central Collateral Trust Mortgage, its right, title and interest in the stock of The Central Railroad Company of New Jersey; the final disposition of said stock to be deferred, in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, (41 Stat. 456, 480,) until ordered by said Court (Record, pp. 277, 296-297).

(d) *The Lehigh and Wilkes-Barre Coal Company.* The Central Railroad Company of New Jersey was directed to dispose of all the capital stock of The Lehigh and Wilkes-Barre Coal Company owned by it to persons or corporations who are not its own stockholders, or stockholders of either the Reading Company, the Railway Company or the Coal Company and who, previous to or at the time of the purchase shall qualify as purchasers by a duly executed affidavit in one of the forms annexed to the decree (Record, p. 298).

The Modified Plan was approved by the present Attorney General of the United States, except as to the disposition to be made of the stock of The Central Railroad Company of New Jersey (Record, p. 277).

On May 21, 1921, the District Court (Buffington, Davis and Thompson, JJ., sitting under the Expediting Act so-called) rendered an opinion unanimously approving the Modified Plan (Record, p. 278), and on June 6, 1921, entered a Final Decree in accordance with that opinion (Record, p. 287). The Modified Plan is hereinafter called the Plan.

Facts Bearing Upon These Appeals

The book value of the coal property on the books of the Reading Company, taking the par amount of the stock, plus the nominal amount of the claim of the Reading Company against the Coal Company as carried on the books of those companies as of December 31, 1920

(Record, p. 162), was..... \$77,357,017.99

From the Coal Company, the

Reading Company will receive

\$35,000,000 as follows (Record,

p. 163):

Cash and cash assets

from Coal Company \$10,000,000

4% Mortgage Bonds of

Coal Company at par 25,000,000

Total \$35,000,000

The book loss to the Reading Com-

pany on the settlement with the

Coal Company will be \$42,357,017.99

For its right, title and interest in
the stock of the Coal Company
after the settlement has been
made the Reading Company will
receive from the new corporation
(Record, p. 275) \$5,600,000.00

The net book loss to the Reading
Company upon the completed
transaction therefore will be.... \$36,757,017.99

The new corporation will sell to the stockhold-
ers of the Reading Company, for \$5,600,000, as-
signable certificates of interest in the stock of
the new corporation, which certificates may be
exchanged for such stock only when accompanied
by an affidavit that the owner does not own any
shares of stock in the Reading Company (Record,
pp. 275, 276). Probably the actual value of the
certificates of interest in the stock of the new
corporation lies somewhere between \$42,357,-
017.99, the book value to the Reading Company
of the interest in the Coal Company sold by it to
the new corporation and \$5,600,000, the purchase
price to be paid by subscribers to the new cor-
poration for certificates of interest. That the
right to subscribe for the certificates of
interest is a valuable right is not denied; just
how valuable it is, is undetermined.

In the brief for the Insurance Com-
panies the statement is made (p. 27) that
the Plan contemplates "a dividend of from
\$13.50, minimum market value, to \$22 actual
value per share" of Reading stock—the smaller
valuation being based upon market quotations for
Reading "rights" so called, and the larger upon
the book value of the coal property on the books
of the Coal Company. The book value on the
books of the Coal Company is larger than that on

the books of the Reading Company by the amount of the accumulated book surplus of the Coal Company; but it is not believed that the certificates of interest can be sold under pressure of the decree in this cause for a sum as great even as the book value of the coal property on the books of the Reading Company would indicate (Record, p. 163). Reading "rights," so called, are dealt in on the Curb "when as and if issued." As the "rights" have no existence pending the decision of this Court the quotations for them represent transactions in which some sell non-existent "rights" without delivering them, and others buy the "rights" without paying for them. Such quotations do not furnish a very reliable indication of what the stockholders of the Reading Company may expect to realize for the "rights," or for the certificates of interest, when transactions cease to be hypothetical and the market reflects forced selling by all holders who are unwilling to part with their Reading stock.

The question of actual value is not, however, of importance on these appeals, for concededly the right to subscribe for the certificates of interest is a valuable right and the legal principles governing the disposition of that right must be the same whether its actual value be greater or less.

THE PRESENT ISSUE.

The appellants contend that the right to subscribe for the certificates of interest described in paragraph (a) of the above summary (paragraph five of the Plan—Record, p. 275) belongs to the common stockholders of the Reading Company, and to them alone, to the exclusion of preferred stockholders (Record, pp. 317-320, 333-337). The Reading Company believes that the right to subscribe was properly accorded to all stockholders, share and share alike. This is the only issue presented by these appeals.

ARGUMENT.

I.

The preferred stock of the Reading Company, though preferred and limited as to current dividends to 4%, is neither preferred nor limited as to assets.

Preferred stocks for the purposes of the present discussion may be roughly classified as follows:

(1) Non-Participating Preferred Stocks.

Non-participating preferred stocks are by their terms preferred both as to dividends and assets. The holders are entitled to receive a specified dividend if earned, and in case of liquidation or dissolution are entitled to receive the par amount of their shares out of the assets of the company before any payment is made to the holders of the common stock, but if the assets exceed the par value of the preferred and common stocks together they are not entitled to share in such surplus assets, which go to the holders of the common stock exclusively. The preferred dividend may or may not be cumulative. Since the holders of preferred stock of this character have an interest in the capital assets of the company only to the extent of the par value of their shares, they should not be entitled to share with the holders of common stock in a stock dividend nor to subscribe ratably with the holders of common stock for any new issue of stock since their interest is not affected by an increase in the com-

mon stock. There is complete mutuality. The common stockholders consent that in the event of liquidation or dissolution of the enterprise the preferred stockholders shall be entitled to receive the full par value of their stock, though the assets be insufficient to pay one cent to the common, and, on the other hand, the preferred stockholders agree that if the assets are more than sufficient to pay them and the common stockholders the par value of their stock, then the surplus assets shall go to the common stockholders exclusively. Although it is dangerous to generalize, it seems to be the more modern fashion to issue preferred stocks of this character. The preferred stocks discussed in the following cases cited in the briefs of the appellants are of this character: *Stone v. United States Envelope Company*, 119 Me. 394; *Russell v. American Gas and Electric Company*, 152 App. Div. (N. Y.) 136; *Niles v. Ludlow Valve Mfg. Company*, 196 Fed. Rep. 994, 202 Fed. Rep. 141; *Will v. United Lankat Plantations Company*, 106 L. T. Rep. (N. S.) 531, [1912], 2 Ch. 571, [1914] A. C. 11.

(2) *Participating Preferred Stocks.*

(a) *Participating as to Dividends.* Preferred stocks of this character are preferred but not limited as to dividends. The holders are entitled to receive a stipulated dividend before any payment is made on the common stock, and after the common stock has received a like dividend, are entitled to participate ratably in any distribution of the remaining surplus earnings.

(b) *Participating as to Assets.* Preferred stocks of this character are generally not preferred and never limited as to assets. In case of the liquidation or dissolution of the cor-

poration, the holders of such preferred stocks share ratably with the holders of the common stock in the assets. If there are sufficient assets to pay the par value of both the common and preferred in full, any surplus is shared ratably by the preferred and common stockholders; if there are insufficient assets to pay the par value of both the preferred and common in full, any deficit is borne ratably by the preferred and common stockholders.

(c) *Fully Participating Preferred Stocks.* These stocks combine the characteristics of (a) and (b).

Participating preferred stocks are discussed in the cases cited in points II and VIII of this Argument.

No attempt is made here to describe every possible permutation and combination of the above principal factors. It is safe to say that the foregoing are the general categories into which preferred stocks may properly be classified for purposes of this discussion.

Preferred stock which is non-cumulative as to dividends ought, as a matter of sound financial structure, to be participating as to assets in order that, if the holders of such stock are forced to contribute to the strength of the corporate enterprise by foregoing their dividends, they may participate fully in the resulting enhancement of the assets in case it becomes necessary to dispose of them otherwise than by way of current dividends.

Similarly, if the preferred stock is entitled to participation as to assets, it is highly desirable that the privilege of redemption be reserved by the company in order that it may be possible to retire it if in the interests of the company it

should prove advantageous to do so—a privilege which would doubtless be of little or no value in the case of a stock bearing non-cumulative dividends at a rate as low as 4% which did not have the participating feature.

The Reading Company's preferred stock falls into (2 b) of these categories: it is a non-cumulative, semi-participating, redeemable preferred stock, preferred and limited as to current dividends, but otherwise fully participating (Record, pp. 88-93, 181).

A quarter of a century ago, when the present issues of stock were made, the Reading Company had been through a drastic reorganization, and had a record of misfortune (Record, pp. 216-227, 259). To give the common stock any value at all at the time and ensure the consummation of the reorganization, it was doubtless necessary not only to limit the current dividend on the preferred stock to 4%, but to make that dividend non-cumulative, and to deny the preferred stock any preference as to assets. The possibility of a financial disaster must have been very much present to the minds of the security-holders of the Reading Company when it made its first bow after the reorganization of 1896. To confer a preference as to assets on the preferred stock would have been to give it an advantage over the common, in the then not improbable event of a further reorganization, altogether incommensurate with the value which, as a non-dividend paying non-cumulative 4% stock, it had during the early years of the reorganized company. True, it followed as a matter of course from the absence of any preference as to assets, that no limitation was imposed as to participa-

tion in assets; but that no doubt did not seem a very important matter to holders of the common stock at the time of the reorganization. The Reading Company did not pay any dividend on the preferred stock until 1900, nor the full dividend on the preferred until 1903, and did not pay any dividend on the common stock until 1905 (Record, p. 58).

The fact that Reading preferred was neither preferred nor limited as to assets was well understood, and the application, made to the New York Stock Exchange for listing the stock of the Reading Company upon the dissolution of the voting trust, (Listing Statements, New York Stock Exchange, Vol. 7, A2986 Oct. 15, 1904) contains the following statement (Record, p. 180):

"The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets."

The fact that the preferred was entitled to full participation in any distribution of the assets otherwise than by way of dividend was recognized by the market. After the decision of this Court directing the dissolution of the Reading combination the preferred stock of the Reading Company sold as high as \$61 per \$50 share of first preferred stock and \$65 per \$50 share of second preferred stock, that is at premiums of 22% and 30% of par respectively. The preferred stocks fell off later, however, and, after the announcement of the Plan, sold at \$45 for the first preferred and \$46 for the second preferred, or a discount of eight or ten per cent. of the par value thereof. (Record, pp. 123, 124, 128). Reading preferred stocks sell higher than other preferred stocks for years

recognized as their equal in soundness and security, for example, Norfolk & Western Railway preferred, and Union Pacific Railroad preferred, both 4% non-cumulative stocks (Record, pp. 123, 124).

Notwithstanding the facts above stated concerning preferred stocks in general (which are a matter of common knowledge) the view is advanced in the brief for the Insurance Companies that all preferred stocks are, or ought to be, alike (pp. 56, 59) :

"Stock certificates, preferred and common, are sold in vast volume throughout the United States.

"The term 'preferred stock' has acquired a well-defined meaning. The Court in the *Stone* case based its decision largely on 'the common meaning of the language.' It would be most unfortunate for preferred stock to mean one thing in one jurisdiction and another thing in another."

* * * * *

"A certificate of preferred stock is a commercial document; likewise a certificate of common stock. The words have a generally accepted commercial meaning. As said by the Court in *Stone v. U. S. Envelope Company, supra*.

"'Surely the phrase 'preferred stock' holds out to the ear of the ordinary investor no promise of participation in earnings beyond his preferential dividend';

and, quoting from *Will v. United Lankat Plantations Company, supra*,

"'Preferential shares of stock are ordinarily spoken of and regarded, and I think properly regarded, as shares of stock which carry a fixed preferential dividend and are not entitled to anything more.'"

This view does not represent the law in Pennsylvania or anywhere else where the right of

contract exists and is protected. It is not the function of the Courts to write contracts for the parties. The dictum quoted from *Will v. United Lankat Plantations Company*, occurs in the opinion of Cozens-Hardy, M. R., in the Court of Appeal. The decision was affirmed in the House of Lords, but there Viscount Haldane, L. C., correctly said, [1914] A. C. 11, p. 15:

"My Lords, this appeal raises a question of great interest from a business point of view, but it is difficult to see how it can be said to raise any question of general legal principle. The point in dispute is one of construction, *and construction must always depend on the terms of the particular instrument*; it is only to a limited extent that other cases decided upon different documents afford any guidance. I make that observation because a good deal of authority has been cited in the course of the argument, and reference has been made to dicta of various learned judges. But in all those cases they were dealing with documents which were different from those we have to construe, and our primary guide must be the language of the documents we have before us." (*Italics ours.*)

There is not one word in the stock certificates of the Reading Company to express or even to suggest the view that its preferred stock is entitled to a preference or is subject to a limitation with respect to the disposition of assets otherwise than by way of customary dividends from current earnings.

This distinction between the rights of the stockholders *inter se* in the case of customary distributions from current earnings, and the rights of the stockholders upon such a disposition as is made of the stock of the Coal Company pursuant to the Plan, is precisely the distinction which was

taken by the District Court in its opinion when, after an analysis of the Plan and reaching the conclusion that "the letter and spirit of the mandate of the Supreme Court are complied with" (Record, p. 280), it said of the stock of the Coal Company (Record, p. 281-282) :

"* * * It is to be taken by the Court and disposed of absolutely by it, by sale through the agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it. * * * Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings. * * * It will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets."

The stock certificates are set out in full in the Record, pp. 82-93. There is no material difference between the certificates originally issued at the time of the reorganization in 1896, set out on pages 82-87 of the Record, and the certificates now in use, set out on pages 88-93, nor, for the purposes of these appeals, between the first and second preferred stocks.

It is clear that the Reading preferred stock is preferred and limited as to current dividends.

It is equally clear that it is neither preferred nor limited as to assets in case of liquidation or dissolution. The problem is presented whether the disposition made of the interest in the Coal Company and of the certificates of interest in the stock of the new coal corporation is to be regarded as governed by the rule applicable to customary dividends from current profits or, on the contrary, by the rule governing the disposition of assets on liquidation or dissolution. The Reading Company believes that a consideration of the decision of this Court, of the interlocutory decree of the District Court entered upon the Mandate of this Court, of the corporate history of the Reading Company, the Coal Company and the Railway Company and of the action taken and to be taken by the Reading Company and the companies which it controlled at the time of the decree, shows conclusively that there are present in this situation few, if any, elements characteristic of customary dividends, and no current profits to be disposed of; that the accumulated surplus of the Reading Company does not in any sense belong to the common stock, although a question undetermined exists as to the right of the Reading Company to draw upon such surplus for customary dividends; and that, on the other hand, the decree directs and the Plan effects the disposition of all the assets of the Reading Company, the termination of its corporate life, of its business life as a holding company and its regeneration as an operating railroad company, subject to the control of the State and Federal authorities as a common carrier. Surely it is the narrowest sort of a technicality and precisely subversive of the common sense and practical justice of the

situation to assert that such benefits, if any, as may accrue to the stockholders of the Reading Company are to be disposed of under all these circumstances pursuant to the rule governing customary dividends, rather than the rule governing the disposition of assets on liquidation or dissolution.

The Argument will proceed to an analysis of the decided cases, of the facts in the Reading case, and of the contract embodied in the Reading stock certificates, with a view to showing that the rule in the stock certificates governing current dividends is inapplicable to the disposition made of the coal stock and the certificates of interest in the new coal corporation under the Plan; and finally to an analysis of the law and the facts with a view to showing that the rule governing the disposition of assets does apply.

II.

Under the law of Pennsylvania preferred and common stockholders have equal rights except as expressly limited by the terms of the contract between them. No preference or limitation can be implied.

Since the Reading Company is a Pennsylvania corporation (Record, p. 189) the contract between it and its stockholders and between the stockholders *inter sese* should be construed in accordance with the law of Pennsylvania. The Pennsylvania cases establish beyond dispute the principle that, except as otherwise expressly provided in the charter or stock

certificates, preferred and common stockholders have in all respects equal rights and privileges, and that no limitation on these rights is to be implied because of any preference granted. *Englander v. Osborne*, 261 Pa. St. 366; *Sterling v. H. F. Watson Company*, 241 Pa. St. 105; *Sternbergh v. Brock*, 225 Pa. St. 279; *Fidelity Trust Company v. Lehigh Valley Railroad Company*, 215 Pa. St. 610.

In *Fidelity Trust Company v. Lehigh Valley Railroad Company*, 215 Pa. St. 610, the Railroad Company had issued preferred stock subject to the following charter provisions:

"And the said additional stock so issued shall be entitled to a preference over all the other stock of the said company, in every future dividend of profits which may be declared by the said company, until the holders of such additional stock shall have been paid, from the funds applicable to the payment of such dividend, ten per cent. per annum on the amount of the capital stock of the company represented by said shares of additional stock so held by them respectively; and the holders of the other stock of the company shall not be entitled to participate in any future dividend of the profits of the company until the holders of said additional stock shall have been paid from the funds applicable to such dividend, ten per cent. per annum on the amount of the capital stock of the company represented by said additional shares so held by them respectively."

Dividends were declared for many years in varying amounts, but all dividends in excess of 10% had always been declared equally to common and preferred. From 1893 to 1904 no dividends were declared, and in 1904 a dividend of 10% on the preferred and 1% on the common

was declared. A preferred stockholder filed a bill to enjoin the payment of any dividends to the common until the preferred had been paid cumulative dividends of 10%. The injunction was granted, the Court holding that the dividends were cumulative, and that the dividends in excess of 10% paid to the preferred stockholders had been properly paid and could not be charged against the arrears of dividends due. In discussing the last point the Court said at page 617:

"The preference created by the statute gave to the holders of the preferred stock, the right to receive \$5 per share per annum on each share of stock held by them, before the other stockholders were entitled to anything. That was the extent of the preference. If the funds applicable to a dividend amounted to just enough for that purpose the other stockholders took nothing. But when each class of stock had been paid 10 per cent., they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors, nor was the amount paid to them in excess of 10 per cent. in any one year to be charged to them as an advance payment upon any future dividends that might be earned or divided in coming years. There was no preference shown in the distribution of these extra dividends. All the shareholders fared alike in so far as they were concerned. The preference created under the act of assembly went only so far as to give to the preferred stockholders a right to claim the first proceeds out of the fund applicable to dividends, to the extent of \$5 per share, per annum on their stock, and no farther. After that amount was paid the common

stockholders were entitled to participate, and did so participate, taking during the years when the extra dividends were paid, the same amount per share, as the preferred stockholders. So that the extra payments during the years mentioned cannot be considered as overpayments to the holders of preferred stock. If the preferred stockholders had been limited, under the terms of the contract, to 10 per cent. per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound. But there is no such limitation in the act. The preferred stockholders stood upon the same plane as the others, with the additional advantage that they had the first right to partake in the distribution of profits up to the limit of \$5 per share per annum, and if necessary, the whole amount of the profits might be taken for that purpose, even if thereby the other stockholders were excluded. We agree with the conclusion of the learned Court below, that the holders of preferred stock are entitled to have the arrears paid to them by the defendant company, without any deduction on account of dividends paid at a time when there had been no deficit. In so far as the excess of such payments over the 10 per cent. per annum to the preferred stockholders was concerned, it was declared not as a matter of preference, but as an equal distribution to all stockholders."

The case of *Sternbergh v. Brock*, 225 Pa. St. 279, involved a slightly different question, but the same principle was involved, and the Court followed the same general rule. Preferred stock had been issued in 1899 by the American Iron & Steel Company, which was entitled

"to receive a cumulative yearly dividend of five per cent. payable quarterly on the first days of January, April, July, and October, in each year before any dividends shall be set apart or paid on the common stock; (b) to be paid in full both principal and accrued dividends in the event of liquidation or dissolution of the company before any amount shall be paid to the holders of the common or general stock; * * *"

From 1899 until 1907 5% was paid on the preferred stock. In 1905 and 1906 a dividend of more than 5% was paid to the common stockholders. In 1907 a quarterly dividend of 2% was declared on all the stock both common and preferred. A common stockholder sought to enjoin the declaration of a dividend greater than 5% to the preferred. The Court refused the injunction. The Court said on page 286:

"Where there is no stipulation to the contrary, the weight of authority clearly favors the right of preferred stockholders, to share with the common stockholders, in all profits distributed, after the latter have received an amount equal to the stipulated dividend on the preferred stock.

"In the absence of special provisions, the holders of preferred stock in a corporation are in precisely the same position, both with respect to the corporation itself and with respect to creditors of the corporation, as the holders of common stock, except only that they are entitled to receive dividends on their shares, to the extent guaranteed or agreed upon, before any dividends can be paid to the holders of common stock': 2 *Clark & Marshall on Priv. Corp.* (1901), Sec. 417c."

In the case of *Sterling v. H. F. Watson Company*, 241 Pa. St. 105, the preferred stock certifi-

cate of the H. F. Watson Company contained the following clause:

"The stock represented by this certificate is a portion of the preferred stock authorized by the stockholders, in pursuance of the Acts of Assembly of April 18, 1874, P. L. 61; April 3, 1872, P. L. 37, and April 28, 1873, P. L. 79, is entitled to cumulative semi-annual dividends of four per cent. each on the par value of the stock, payable from the net earnings of the company; and is subject to the right of the H. F. Watson Company, at its option, to retire and extinguish the same, upon the payment to the owner thereof all arrears of dividends, and the par value thereof, at any time after April 6, 1907."

The Company declared a stock dividend of 25% payable to both common and preferred stockholders. Later the Company resolved to redeem the preferred stock by paying the par value and accrued dividends less the par value of the 25% stock dividend which had been declared eight years before. This deduction was enjoined. The Court said at page 110:

"The fact that a stock dividend of 25 per centum of the issue then outstanding was declared and the stock thus issued divided between the common and preferred shareholders according to their respective holdings has no bearing on the question involved in this controversy. Whether this be regarded as a gratuity to all stockholders, or as representing the value of current assets, makes no difference so far as the right of the preferred shareholders to demand as a preference payment of their dividends at the rate of 4 per centum semi-annually out of the net earnings. This was a preference to which these shareholders were entitled under

their contract, and before the preferred stock is retired these dividends must be paid as provided in the certificates. It was so stipulated in the contract with the preferred shareholders, and they have the right to insist upon performance according to the terms of that contract. These dividends are preferences and not limitations. When the preferred dividends are paid, and dividends out of the net earnings from year to year of an equal amount have been declared and paid on the common stock, then all of the stock, common and preferred, has the right to participate in the distribution of surplus earnings upon an equal basis."

* * * * *

"The principle is sound and is sustained by the great weight of authority. We agree with the learned Court below that in principle these cases rule the one at bar. In the present case appellant corporation distributed among all of its stockholders an additional issue of stock, and in the division of this stock no distinction was made between common and preferred shareholders, but this was a matter for the stockholders to determine in the issue of the new stock and it in no way affected the preference in the payment of semi-annual dividends to which the preferred stock was entitled. That the new stock was not issued as a preference to preferred shareholders is shown by the fact that it was distributed to holders of common and preferred stock alike according to their respective holdings."

In the case of *Englander v. Osborne*, 261 Pa. St. 366, the preferred stock certificate of the Hoffman, De Witt & McDonough Company provided:

"The holders of the preferred stock shall be entitled to receive when and as declared and the company shall be bound to

pay a fixed yearly cumulative dividend of six per cent. (6%) payable quarterly, before any dividend shall be set apart on the common stock."

No dividends had been paid for nine years. The Company declared a dividend of 54% on both the preferred and common stock. A preferred stockholder obtained an injunction against the payment of this dividend to the common, the Court holding that after the preferred had received their cumulative dividends the common was entitled to 6% only, and that any further dividend must go equally to both common and preferred. The Court said at page 369:

"The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock. When a dividend is declared the former are entitled to first claim to the extent of their preference for the current year and if there remains a sum more than sufficient to pay a similar dividend on the common stock, both classes of stockholders are entitled to share equally in the excess. In absence of agreement, express or implied, that dividends shall be cumulative, unpaid dividends in the past cannot be claimed: 10 Cyc. 573.

"Likewise there is no logical reason for holding that common stockholders are entitled to go back of the current year, and claim to be reimbursed for unearned dividends in past years. To do so would render such dividends cumulative in effect without agreement. Accordingly, when during previous years no dividends were earned this was conclusive as to the right of all stockholders, both preferred and common, except for the contractual right

of the former to payment out of future profits to the extent of their preference before the latter would be entitled to participate in the earnings. So far as the holders of the common stock were concerned their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period: * * *

These cases set out a clear, logical and consistent rule that the preferred and common stockholders are entitled to share equally in all assets of the corporation, whether such assets be capital, unearned increment, or current or accumulated earnings, except in so far as such assets are otherwise expressly disposed of by the charter or stock certificate, and that no limitation upon the participation of the preferred stock will be implied.

The fact relied upon in the brief for the Prosser Committee (p. 82), that the preferred stocks considered in most of these Pennsylvania cases were cumulative, adds rather than detracts from their force as precedents in the Reading case. As already indicated in point I of this Argument, participation in assets is really essential to the security and soundness of a non-cumulative preferred stock such as the Reading. Without such participation dividends which are passed are lost to the preferred stock forever and go to the enhancement of the value of the property, which would inure to the benefit of the common stock to the exclusion of the preferred. On the other hand, in the case of cumulative preferred stocks, participation in assets is wholly unnecessary for the soundness of the security, although of course, desirable if obtainable as part of the terms of the original issue.

III.

The law of Pennsylvania, as settled by the decisions of the Supreme Court of Pennsylvania, was properly followed by the District Court in the construction of the contract between the Reading Company and its stockholders and between the stockholders *inter sese*.

The Pennsylvania cases were properly followed by the Court below in construing the contract between the Reading Company, a Pennsylvania corporation, and its stockholders. There is only one contract, the same for all stockholders of the Reading Company. That contract has one very clear meaning under the Pennsylvania decisions. It would be very unfortunate if the Federal courts were to undertake to construe a contract between a corporation and its stockholders differently from the State courts. The Federal courts would not, of course, undertake to construe a charter granted by the Commonwealth of Pennsylvania differently from the State courts. If the Federal courts were to attempt to do so the effect would be that the judicial branch of the Federal Government was enlarging or curtailing the powers granted to a corporation by a sovereign act of the State. *Equitable Life Assurance Society of the United States v. Brown*, 213 U. S. 25; *First National Bank of Ottawa v. Converse*, 200 U. S. 425; *Sioux City R. R. Company v. N. A. Trust Company*, 173 U. S. 99; *Black et al. v. Zacharie & Company*, 3 How. 483.

In *Equitable Life Assurance Society v. Brown*, 213 U. S. 25 the complainant, a policy holder of the defendant Insurance Company, alleged that under the charter of the defendant and the provisions of his policy, the defendant was trustee of its surplus for its policy holders and not for its stockholders. This Court in deciding that no trust for the policy holders existed looked to the New York cases construing the charter and policy of the defendant, saying at page 43:

"Before discussing the merits of the case it is also proper to first decide what force is to be given the decisions of the highest court of New York with reference to the construction of the charter of the defendant and the policy of insurance issued by it. *Greeff v. Equitable Life, &c.*, 160 N. Y. 19. Although the charter was obtained under a general law of the State of New York relating to the incorporation of insurance companies, yet the construction to be given that act and the charter obtained in pursuance of it pertains to the state courts just as if the charter were granted by a special act of the legislature. Ever since its incorporation under the general law of the State of New York, in 1859, the defendant has always done business and had its general home office and its legal residence and domicile in that State. The insurance policy owned by the complainant appears on its face to have been executed in New York and there is no averment to the contrary. The decisions of the highest court of New York are therefore binding upon this court as to the meaning and effect of the charter of the defendant, and as it is a New York company and the contract is a New York contract, executed and to be carried out therein, its meaning and construction as held by the highest court of the State will be of most persuasive influence, even if not of binding force, in the

absence of any Federal question arising in the case. There is no such question here. *Stone v. Wisconsin*, 94 U. S. 181, 183; *Park Bank v. Remsen*, 158 U. S. 337, 342; *Sioux City &c. Co. v. Trust Co.*, 173 U. S. 99. This principle has been so frequently decided that further reference to adjudged cases need not be made."

In *First National Bank of Ottawa v. Converse*, 200 U. S. 425, the question was whether a Minnesota corporation was a manufacturing corporation and so whether the stockholders of the corporation were exempt from a "double liability statute." The court followed the state court, saying, at page 438:

"Accepting this construction given by the Supreme Court of Minnesota to the articles of association by which alone the incorporators under those articles can be taken out of the exemption accorded by the constitution of Minnesota, it follows that the thrasher company was organized to embark in the purely speculative business of buying and selling the stock and assets of an existing and insolvent corporation, with power, but without the obligation, to engage as an independent enterprise in a manufacturing business."

In *Sioux City Railroad Company v. N. A. Trust Company*, 173 U. S. 99, an Iowa corporation had issued bonds in excess of two-thirds of the paid-up capital stock of the company, the limit contained in its charter pursuant to statute. The Supreme Court of Iowa had frequently held that the fact that an Iowa corporation contracted debts in excess of its charter limitation did not render the debt void, but merely gave rise to an action on the part of the state. This Court said at page 112:

"Whether, as an independent question, if we were enforcing the Iowa statute, we

would decide that the issue of stock by a corporation in excess of a statutory inhibition was not void but merely voidable, need not be considered, since, as we have said, in applying an Iowa law, we follow the settled construction given to it by the Supreme Court of that State."

In *Black et al. v. Zacharie & Company*, 3 How. 483, shares of stock in two Louisiana corporations belonging to a citizen of South Carolina were attached in a suit by a creditor in the Federal court in Louisiana. The stockholder had previously assigned the attached stock by a trust deed for the benefit of his creditors. Mr. Justice Story said at page 511:

"We admit, that the validity of this assignment to pass the right to Black in the stock attached depends upon the law of Louisiana and not upon that of South Carolina. From the nature of the stock of a corporation, which is created by and under the authority of a state, it is necessarily, like every other attribute of the corporation, to be governed by the local law of that state, and not by the local law of any foreign state. And in the present case, if the local law of Louisiana had prohibited: (as we think it had not) any assignment of an equitable interest in the stock attached, *we should not have scrupled to have followed that law.* * * *

"Out of Louisiana, we believe that no such question could possibly arise; for courts of law, as well as courts of equity, are constantly, in all states where the common law prevails, in the habit of holding a prior assignment of the equitable interest in stock as superseding the rights of attaching creditors, who attach the same with a full knowledge of the assignment.

"Upon full examination of the laws of Louisiana and the decisions of its courts,

we see no reason to believe that a different doctrine on this subject prevails in that state." (Italics ours.)

This opinion was written by Mr. Justice Story whose opinion in *Swift v. Tyson*, 16 Pet. 1, established the rule that in matters of general jurisprudence the Federal courts are not concluded by the decisions of State courts.

The appellants have cited the following cases: *Kuhn v. Fairmont Coal Company*, 215 U. S. 349; *Beutler v. Grand Trunk Junction Railway Company*, 224 U. S. 85, 88; *Lane v. Vick*, 3 How. 464; *Foxcroft v. Mallett*, 4 How. 351, 359; *Swift v. Tyson*, 16 Pet. 1; *Carpenter v. Providence Washington Insurance Company*, 16 Pet. 495, 511; *Actna Life Insurance Company v. Moore*, 231 U. S. 543; *Burgess v. Seligman*, 107 U. S. 20; *Clark v. Bever*, 139 U. S. 96.

The first seven of these cases have nothing to do with the binding force of a State court's decisions affecting corporations created by act of the State. In the other two cases the State court decisions which the Federal courts did not follow were rendered after the litigation in the Federal courts had begun.

Every consideration of public policy and of comity supports the view that the Federal courts should, in construing the charter and act of incorporation and stock certificates of a corporation, follow the decisions of the courts of the State which created the corporation. The decision of the Court below to follow the Pennsylvania decisions was entirely proper and in conformity with sound precedents and does not furnish a basis for appeal.

IV.

The authorities relied upon by the appellants dealing with the rights of stockholders *inter sese* are from jurisdictions foreign to Pennsylvania and are distinguishable from the present case.

The following cases, most of them from jurisdictions other than Pennsylvania, are those chiefly relied upon by counsel for the appellants, to prove that the common stockholders are exclusively entitled to the right to subscribe to certificates of interest in the stock of the new corporation. *The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Company*, 212 N. Y. 360; *Scott v. The Baltimore and Ohio Railroad Company*, 93 Md. 475; *Stone v. United States Envelope Company*, 119 Me. 394; *Russell v. American Gas and Electric Company*, 152 App. Div. (N. Y.) 136; *Niles v. Ludlow Valve Mfg. Company*, 196 Fed. Rep. 994, 202 Fed. Rep. 141; *Will v. United Lankat Plantations Company*, 106 L. T. Rep. (N. S.) 531, [1912] 2 Ch. 571, [1914] A. C. 11; *St. John v. Erie R. R. Company*, 22 Wall. 136; *Keith v. Carbon Steel Company* (U. S. Dist. Ct., W. Dist., Pa. not reported.)

(a) The Union Pacific Cases.

The Equitable Life Assurance Society of the United States v. Union Pacific Railroad Co., 212 N. Y. 360. The Union Pacific Railroad Company had declared a dividend to the common stockholders exclusively, consisting of (1) three dollars

in cash; (2) twelve dollars par value of preferred stock of The Baltimore and Ohio Railroad Company; (3) twenty-two and a half dollars par value of the common stock of The Baltimore and Ohio Railroad Company. The regular dividend on the common stock was at the same time reduced from ten per cent. to eight per cent., the reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provided:

"The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company, to dividends in each and every fiscal year at such rate *not exceeding 4 per cent. per annum*, payable out of the net profits as shall be declared by the Board of Directors.

"Such dividends are non-cumulative and *such Preferred Stock is entitled to no other or further share of the profits.*" (Italics ours.)

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, that the preferred stockholders by the express terms of the stock certificates having received four per cent. dividends were entitled to no other or further share of the profits, and that the dividend was properly declared to the common stockholders. The distinguishing factor is that the Union Pacific preferred stock certificates expressly provided that "*such Preferred Stock is entitled to no other or further share of the profits.*" As the Court found that the dividend in that case was declared out of profits, the express language of the certificate controlled its decision. That language was perfectly clear and was broad enough

to exclude the Union Pacific preferred stock from any share of the profits whether by way of dividends or otherwise and whether in the ordinary course of business or upon the liquidation or dissolution of the corporation. The Reading preferred stock certificate, on the other hand, contains no preference or limitation, expressly or by implication, except as to participation in current dividends.

Moreover, the decree in the Reading case involves the involuntary separation from the Reading Company of what was an integral part of the business for which it was recreated in connection with the reorganization of 1896. (See point IX of this Argument.) This distinguishes the Reading case in a most marked way from the *Union Pacific* case. The larger part of the Union Pacific holdings of Baltimore and Ohio stock had been acquired in exchange for Southern Pacific stock in connection with the dissolution of the Union Pacific-Southern Pacific combination less than a year before the dividend was declared. Though the Union Pacific Railroad Company was forced to sell its Southern Pacific stock (which as a matter of fact it did sell to its preferred and common stockholders *pro rata*), it was not forced to sell its holdings of Baltimore and Ohio stock or to dispose of them in any way, for the legality of its ownership of the Baltimore and Ohio stock had not been questioned. The Union Pacific parted with its holdings of Baltimore and Ohio stock voluntarily by way of dividend. There were not in that case any of the elements relied upon in the present case in support of the Plan.

The case of *United States v. Union Pacific Railroad Company*, 226 U. S. 61, 470, referred to in the Plan (Record, pp. 43, 275) as the Union

Pacific-Southern Pacific case, was relied upon by the Reading Company in support of its affirmative answer to the following question (not in issue on these appeals) submitted by the District Court among other questions for argument in its order filed April 12, 1921 (Record, p. 206):

"Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful."

Although in fact the Union Pacific did sell its Southern Pacific stock or a portion thereof to its stockholders, preferred and common, share and share alike, that case has no bearing one way or another upon the question at issue upon these appeals, for the Southern Pacific stock was sold at or about its market value.

(b) *The Baltimore and Ohio Case.*

Scott v. The Baltimore and Ohio Railroad Company, 93 Md. 475. The preferred stock certificate of the Baltimore and Ohio provided:

"The holders of Preferred Stock * * * are entitled to receive in each year out of the surplus net profits of the Company for the current year, such yearly dividend (non-cumulative) as the Board of Directors of said Railroad Company may declare, up to but not exceeding four per centum, before any dividends shall be set apart or paid upon the Common Stock."

The only question involved in this case was the right of the preferred stockholders to divi-

dends in excess of four per cent. out of the current earnings of each fiscal year. No question was involved as to the right to share in accumulated earnings or in capital accretion. This is clearly shown by the pleadings in the Circuit Court of Baltimore City.

The court held that the preferred stockholders were only entitled to 4 per cent. out of the net earnings for the current year and that the Baltimore and Ohio could lawfully pay dividends from current earnings in excess of 4% on the common stock without participation by the preferred. This decision is in accord, therefore, with the theory and practice of the Reading Company under which the preferred stockholders of the Reading Company are only entitled to 4 per cent. from current surplus net earnings, though dividends therefrom are paid at a higher rate on the common stock.

The rights of preferred stockholders in accumulated earnings or accretions to capital were not involved in the case, and any expression of opinion about such rights was *dictum*.

(c) Cases of preferred stocks expressly preferred as to assets.

In the following cases the preferred stocks were all by express provision preferred as to assets. In the Reading case there is no preference as to assets, and these cases do not in any way qualify the proposition, which is elementary, that such a stock as the Reading, which contains no express provision one way or the other, is neither preferred nor limited as to assets.

Stone v. United States Envelope Company, 119 Me. 394. This case involved an issue of additional stock by the defendant company whose

preferred stock was preferred by its terms both as to dividends and assets. The Maine Court stated that the Pennsylvania rule was not in accord with its decision, saying at page 396:

"There are two opposing theories, each of which has judicial support. One theory is that the preferred stockholder presumptively yields nothing in compensation for the benefits which he receives; that he has and holds all the rights of the common shareholder and in addition has his preferential rights.

"Upon this theory the defendant relies, and in support of it cites *Jones v. Railroad Co.*, 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650 (1892), and a series of cases in Pennsylvania, the latest of which, *Englander v. Osborne*, 261 Pa. 366, 104 Atl. 614, 6 A. L. R. 800, affirms the earlier decisions.

"Clark & Marshall on Corporations and also Cook (6th Ed.) are cited by the defendant. These works were written and published before the cases of *Niles v. Ludlow Valve Mfg. Co.* and *Will v. U. L. P. Co.*, *infra*, were decided. But even the sixth edition of Cook says that 'the question is an open one.' Section 269, p. 1.

"The other theory, which we believe to be better and supported by the weight of authority, is that, in receiving the greater security of his preferential rights, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation."

Russell v. American Gas and Electric Company, 152 App. Div. (N. Y.) 136. The preferred stock of the defendant corporation was entitled by its terms to cumulative dividends and to preference in the distribution of assets until the par value and accumulated dividends had been paid and "to no further dividend or distribution." The corpora-

tion offered the right to subscribe to an issue of common stock to the common stockholders to the exclusion of the preferred. A preferred stockholder sought to enjoin the issue unless the preferred stockholders were also given the right to subscribe. The Court held that the preferred stockholders were not entitled to share in the right to subscribe.

Niles v. Ludlow Valve Mfg. Company, 196 Fed. Rep. 994, 202 Fed. Rep. 141. This case involved the issue of additional stock by a New Jersey corporation. The preferred stock was preferred by its terms as to assets as well as dividends, and was held to have no right to participate in this issue.

The real basis of these three decisions is that where preferred stockholders are preferred and limited as to assets, their interest in the assets of the corporation is not affected by the issue of additional common stock, since they are entitled only to the par value of their stock from assets, the balance belonging to the common. This is clearly recognized in the opinion of Judge Hough in *Niles v. Ludlow Valve Mfg. Company*, in which he says:

"It is, I think, true that underlying the question on the surface of this case is the inquiry: What would have been the rights of the preferred shareholders, had this company gone into involuntary dissolution with a large accumulation of earnings in its treasury, so that after paying every shareholder, whether common or preferred, 100 cents on the dollar, this surplus would still have remained."

In *Russell v. American Gas and Electric Company*, the preferred stock was by its terms not only preferred but also limited as to assets, and this

decision is not contrary to the Pennsylvania rule. The doctrine in Pennsylvania differs from the doctrine in the other two cases, to this extent and this extent only, that in these cases the Courts hold that an express preference carries with it by implication a corresponding limitation; while the Pennsylvania Courts hold that a limitation must be equally express and cannot be implied from an express preference. None of the cases cited on behalf of the appellants in any way detracts from the doctrine established by the House of Lords in *Birch v. Cropper*, 14 A. C. 525 (the *Bridge-water* case), by the New Hampshire Court in *Jones v. Concord & Montreal Railroad Company*, 67 N. H. 119, 234, and by the New Jersey Court in *Wood v. The Pennsylvania Electric Vehicle Company*, 75 N. J. Eq. 263 (discussed in point VIII of this Argument), that, in the absence of any express preference or limitation as to assets, preferred and common stocks share equally in assets. No case has been found in any jurisdiction in which a limitation as to assets has been implied from a preference as to dividends. In the *Lloyd* case it was expressly said that a preference as to dividends did not imply either a preference or limitation as to assets (point VIII, p. 62 of this Argument).

The Reading stock certificates contain no preference as to assets, and therefore under either rule there is no limitation as to assets.

Will v. United Lankat Plantations Company, 106 L. T. Rep. (N. S.) 531, [1912] 2 Ch. 571, [1914] A. C. 11. The company declared a dividend payable only to the common stockholders in the shares of another company which it had received in payment for certain property. The preferred stockholders claimed the right to participate in this

dividend. The preferred stock had been created after the company had been engaged in business for two years, and was preferred as to both dividends and assets. The original articles of associations provided in Article 115:

"Subject to any priorities that may be given upon the issue of any new shares, the profits of the company available for distribution * * * shall be distributed as a dividend among the members in accordance with the amounts paid on the shares held by them respectively."

After the issue of the preferred shares, but prior to the declaration of this dividend the following Article had been substituted for Article 115:

"Subject to any priorities that may be given upon the issue of any new shares, or may for the time being be subsisting, the profits of the company available for distribution shall be applied first in payment of a cumulative dividend at the rate of 10 per cent. per annum upon the amounts paid on the original preference shares of the company, and subject thereto shall be distributed as dividend among the holders of the ordinary shares in accordance with the amounts for the time being paid on the ordinary shares held by them respectively, other than amounts paid in advance of calls."

The House of Lords treated this question as one of construction, and held that Article 115, as amended, controlled and that therefore the preferred stockholders by its express terms were limited to their preferred dividend.

The *Bridgewater* case represents the law in England applicable to the Reading situation (See point VIII, p. 59).

(d) Miscellaneous.

St. John v. Erie R. R. Company, 22 Wall. 136.

This case involved no question as to the rights of stockholders *inter sese*. Holders of preferred stock entitled by its terms to a preferred dividend out of net earnings for the current year, if earned, not exceeding seven per cent, claimed to be absolutely entitled to receive this dividend, if earned, even though the earnings were insufficient also to pay rental under leases entered into after the creation of the preferred stock. In other words, the preferred stockholders claimed that they should be treated as preferred creditors, but the Court did not sustain this contention. The language quoted from this case in the brief for the Prosser Committee (pp. 41, 61) has no reference to the questions now under consideration.

Keith v. Carbon Steel Company (U. S. Dist. Ct., W. Dist. Pa., not reported). In this case the preferred dividend, and a like dividend to the common stock had been paid and an extra dividend from earnings from the current year was declared to the common stockholders. A preferred stockholder claimed the right to share in this dividend, but the Court held that the common stock was exclusively entitled to it. (The opinion is printed in full as an appendix to the brief for the Insurance Companies). This case is, of course, of no authority on the questions presented on these appeals, since it only decides that the preferred stockholders were not entitled to a dividend from current net earnings in excess of the limitation prescribed by the stock certificate. This has been the interpretation put upon its own stock certificates by the Reading Company for many years. The appellants point out that the decision was rendered by the Federal Court for the Western

District of Pennsylvania, but fail to mention that it concerned stock of a West Virginia corporation. West Virginia law, therefore, and not Pennsylvania law was the law governing the construction of this contract between the corporation and its stockholders, and this was recognized by the Court.

V.

The other authorities relied upon by the appellants are not applicable to the facts of this case.

(1) The brief for the Insurance Companies, (pp. 67 ff), cites the following cases to show that even if the transaction is a sale it is void because made to controlling stockholders for an inadequate consideration: *Southern Pacific Company v. Bogert*, 250 U. S. 483; *Mason v. Pewabic Mining Company*, 133 U. S. 50; *Wardell v. R. R. Company*, 103 U. S. 651; *Twin-Lick Oil Company v. Marbury*, 91 U. S. 587; *Backus v. Brooks*, 195 Fed. Rep. 452; *Jones v. Missouri Edison Electric Company*, 144 Fed. Rep. 765; *Rothchild v. Memphis & C. R. Company*, 113 Fed. Rep. 476; *Mumford v. Ecuador Development Company*, 111 Fed. Rep. 639; *Rogers v. Nashville C. & St. L. Ry. Company*, 91 Fed. Rep. 299; *Ervin v. Oregon Ry. & Navigation Company*, 27 Fed. Rep. 625; *Mecker v. Winthrop Iron Company*, 17 Fed. Rep. 48.

With the exception of *Mason v. Pewabic Mining Company*, 133 U. S. 50, which is discussed below, these cases deal with transactions in which it was alleged that majority stockholders had ex-

exercised their control of the corporation so as to transfer all or a large part of its assets for an inadequate consideration to another corporation in which the minority stockholders had no interest at all or that directors had contracted with the corporation for their own benefit. They are based upon a breach of duty to the corporation by directors for their own benefit or the fraud of the majority stockholders in exercising their control of the corporation for their benefit to the exclusion of the minority stockholders.

In the present case the certificates of interest in the stock of the new coal corporation are to be disposed of to all the stockholders, preferred and common, share and share alike. The only question is whether the appellants, representing a minority of the common stock, shall prevail in their contention that the holders of the preferred stock should be excluded from participation in such benefits as may accrue to those having the right to subscribe for certificates of interest in stock of the new coal corporation.

In *Mason v. Pewabic Mining Company*, 133 U. S. 50, the charter of the defendant corporation had expired and instead of liquidating the business, the majority stockholders voted to sell all its property supposedly worth \$500,000 to a new corporation for \$50,000, shares in the new corporation to be issued in exchange for shares of the old corporation, with the option to any stockholder to receive instead of stock in the new corporation his pro rata share of \$50,000 in cash. An injunction was granted on the ground that the majority stockholders could not force the minority to take stock in the new corporation, in the future of which they might have no confidence, or to accept for their stock a value arbi-

trarily fixed by the majority. (See *Geddes v. Anaconda Mining Company*, 254 U. S. 590, 601). It is obvious that no such question is involved in these appeals.

(2) Income tax cases: *United States v. Phellis*, No. 260, October Term, 1921; *Rockefeller v. United States*, No. 535, October Term, 1921; *New York Trust Company v. Edwards*, No. 536, October Term, 1921.

These cases involved the question whether the stock distributed constituted income under the provisions of the Revenue Act of October 3, 1913, Chap. 16 (38 Stat. 114, 166, 167), that income shall include gains derived "from interest, rent, dividends, securities, or * * * gains or profits and income derived from any source whatsoever."

It is conceded that the right to subscribe for certificates of interest in the stock of the new coal corporation is a valuable right. Just how valuable, is undetermined. The question presented by these appeals is not whether the disposition made of the coal property is a dividend or income within the meaning of the income tax law, but whether, in the light of the facts, of the contract embodied in the stock certificates and of the decided cases, the disposition so made comes within the rule governing current dividends or, as believed by the Reading Company, within the rule governing the disposition of assets.

(3) Since the question presented by these appeals is that stated in the preceding paragraph, the following cases cited by the appellants are irrelevant: *Hartley v. Pioneer Iron Works*, 181 N. Y. 73; *Smith v. Moore*, 199 Fed. Rep. 689; *Grants Pass Hardware Company v. Calvert*, 71 Or. 103; *In re Wilson's Estate*, 85 Or. 604; *City of Allegheny v. Pittsburgh, A. & M. P. R. R. Com-*

pany, 179 Pa. St. 414; *Wilder v. Tax Commissioner*, 234 Mass. 470.

(4) The brief for the Insurance Companies, (pp. 29 ff) cites a number of cases most of which deal with the rights of creditors to recover from stockholders unpaid subscriptions to stock or corporate property improperly distributed, or with the distinction between the phrases "capital," "capital stock" and "shares of stock," and have no connection with the present case. The remaining cases (*Alabama Consolidated Coal & Iron Company v. Baltimore Trust Company*, 197 Fed. Rep. 347; *Excelsior Water and Mining Company v. Pierce*, 90 Cal. 131; *Hubbard v. Weare*, 79 Iowa 678; *Williams v. The Western Union Telegraph Company*, 93 N. Y. 162; *Bassett v. U. S. Cast Iron Pipe and Foundry Company*, 74 N. J. Eq. 668; *Lubbock v. British Bank of South America* [1892] 2 Ch. 198) discuss, from various points of view, the power of directors to treat the assets of a corporation in excess of liabilities and capital stock as surplus available for distribution to stockholders. These cases have no bearing on the present question, since it is not disputed that, as a matter of law, and in the absence of special restrictions, directors may distribute surplus among the stockholders entitled to share therein.

VI.

Considering the character of the action taken, of the asset disposed of, and of the surpluses affected, there are present in the situation none of the elements necessary to bring it within the rule governing current dividends.

The Plan contemplates and the Decree directs a sale of the interest of the Reading Company in the coal property. The price which the Reading Company will receive for the coal property and the selling price of the certificates of interest in the stock of the new corporation to be created pursuant to the Decree were fixed with regard to the requirements of the Reading Company (Record, p. 163). The Plan provides for immediate disposal of the Reading Company's beneficial interest in the coal property. That having been accomplished, it makes the stockholders of the Reading Company a conduit for the transmission of the ownership of the certificates of interest to persons not stockholders in the Reading Company. So great a property as that of the Coal Company cannot, under the peculiar general conditions now existing, and under the peculiar special conditions affecting the Reading coal property, be advantageously sold at this time or in bulk (Record, p. 163). The Plan is not only advantageous from the point of view of prompt compliance with the Mandate of this Court, in that it immediately divests the Reading Company of all ownership and control of the Coal Company, but is also ad-

vantageous to the stockholders of the Reading Company, in that it gives them the benefit of the hope that they may realize more for the property than the Reading Company itself could realize for it in the event of a direct sale (Record, p. 163).

The determination of the question presented on these appeals would not have been avoided by the sale of the stock of the new corporation to outsiders for the best price obtainable. That question was inherent in the situation created by the Mandate of this Court ordering the dissolution of the combination existing and maintained through the Reading Company, and directing that its property be disposed of. The sale to outsiders under the circumstances referred to would have resulted in sacrificing the interests of all the stockholders; and the proceeds of sale would have taken the place of the certificates of interest in the stock of the new corporation as the subject-matter of the controversy.

The stock of the Coal Company is a capital asset, and not in any sense earnings or profits of the Reading Company. It was acquired by the Reading Company in 1896, as part of the consideration for the issue of the present outstanding stocks and bonds (Record, p. 160), and the present book value to the Reading Company of its investment in the coal property is not materially greater than it was at the time of such acquisition (Record, p. 162).

Nor is the book surplus of the Coal Company earnings or profits of the Reading Company. *Pardee v. Harwood Electric Company*, 262 Pa. St. 68; *United States Trust Company of New York v. Heye*, 181 App. Div. 544; 224 N. Y. 242 (a case growing out of the Standard Oil dissolution).

The statement of working assets and current

liabilities of the Reading Company as of December 31, 1920 (Record, p. 202) shows that it was not in a position to make any extraordinary distribution of current profits, and the sale of the coal property does not result in a profit to the Reading Company.

The capital and surplus of the Reading Company will be protected under the Plan by carrying into its books the surplus of the Railway Company which is more than sufficient to counterbalance the loss on the sale of the coal property (Record, p. 169). This is significant in connection with the suggestion of the Prosser Committee in their intervening petition (Record, p. 109) repeated in their brief in this Court (p. 21), that the capital stock of the Reading Company should be reduced. If there were any risk of impairment of capital, or even of such curtailment of surplus as to imperil future dividends, that fact in itself might be a valid objection to the Plan.

Though the surplus of the Railway Company will thus serve to protect the capital and replenish the surplus of the Reading Company, the surplus of the Railway Company is not in fact in such shape as to suggest or indeed, as a matter of sound corporate management, to justify any extraordinary dividend distribution. This is shown by the statement of the working assets and the current liabilities of the Railway Company as of December 31, 1920 (Record, p. 202). The annual report of the Railway Company for the year ending June 30, 1910, contains the following statement (Record, p. 172):

"By command of the Interstate Commerce Commission, we are required to capitalize all betterments and additions which

have been paid for out of income since June 30, 1907.

"The line drawn between renewals and repairs chargeable to Expense Account and Improvements is forcibly illustrated by the ruling on replacements of rails in tracks. If the old rail weighed sixty pounds and the new weighs ninety pounds, one-third of the cost of the new rail must be capitalized. The item on the assets side of the Balance Sheet, amounting to \$4,814,042.76 is the result of the Commission's order. With no counter entry on the liability side of the Balance Sheet, this sum would go to increase 'Profit and Loss.' Some of the railroad companies accept this result. It swells their surplus and has the appearance of wealth. But it seems to your management both misleading and dangerous. Increasing 'Profit and Loss' in this way will again tempt, as it has done in the past, the declaration of large stock dividends, thereby swelling capital on which earnings are to be made. To prevent misleading investors and stockholders, we have decided not to include this in 'Profit and Loss,' but to make the counter entry on the Balance Sheet: 'Appropriated surplus; expenditures on property since June 30, 1907, and charged as an asset.'"

This practice has been continued and the balance sheet of the Railway Company for December 31, 1920 (Record, p. 200), shows the following items:

Additions to Property Through	
Income and Surplus.....	\$53,451,156.59
Profit and Loss.....	10,276,169.32

VII.

The surplus of the Reading Company does not belong to the common stockholders under the circumstances here obtaining.

Though the investment in the coal property is part of the original enterprise and its book value to the Reading Company today does not materially exceed that upon the reorganization in 1896 (Record, p. 162), and it is not contended that its market value exceeds its book value (Record, p. 163); though the capital and surplus of the Reading Company would be protected under the Plan (Record, p. 169); though the transaction does not result in a profit (Record, p. 162), and there is no surplus of a character to suggest or indeed as a matter of sound corporate management to justify, an extraordinary dividend (Record, p. 171); nevertheless the appellants claim that, as the transactions contemplated by the Plan necessitate a charge against the surplus of the Reading Company, representing the difference between the book value of the coal property to the Reading Company, and the selling price to the new corporation (Record, pp. 162, 163), therefore whatever benefits may accrue from the transactions should accrue to the common stockholders alone, to the exclusion of the preferred stockholders, for, say the appellants, the surplus of the Reading Company belongs to the common stockholders exclusively under the circumstances here obtaining (Record, p. 107).

But the surplus of the Reading Company does not *belong* to the common stockholders in any sense whatever, and they cannot rightfully object

to a charge being made against surplus in connection with the transaction now contemplated and under the circumstances now presented. All the property of the Reading Company, including its surplus, belongs, subject to the claims of the creditors and the vicissitudes of the business, to all its stockholders, preferred and common, share and share alike, subject to the right of the directors of the Reading Company to declare dividends pursuant to the contract between the company and its stockholders. That contract makes express provision concerning current dividends but no provision concerning the disposition of assets.

The contract is contained in the stock certificates, copies of which are set forth in the Record, pp. 82-93. For convenience the following excerpts therefrom are quoted here. The numbers and italics are ours.

(1) "The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment *in or for such fiscal year* of any dividends on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom."

(2) "The Second Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment *in or for such fiscal year* of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the

full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom."

(3) "If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company."

(4) "But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

There is nothing in the contract to substantiate the claim that even current surplus *belongs* to the common stockholders. It does not belong to them. It is subject to the risks of the business and such charges and losses as may occur in the conduct of the business, ordinary or extraordinary. The common stockholders cannot maintain an action for it, nor for the payment of dividends from it, in the absence of bad faith. The right of the common stockholders is limited to this: When the board of directors do declare dividends from current earnings, after providing for the full 4% dividends on preferred stocks, they shall be declared as dividends to the common stockholders exclusively. It has been and will no doubt continue to be the Reading Company's practice when practicable to pay dividends from current

earnings at greater rates than 4% without permitting the preferred stock to participate in such dividends (Record, p. 58). That practice rests not upon any doubtful practical construction but upon the clear provision of the contract. The express grant in the stock certificates (clause 3 above) of authority to the directors, after providing for the full dividend on the preferred, is to *pay* dividends to the common stock out of current surplus net profits remaining (not merely to permit the common stock to *participate* in such dividends).

It is conceded that surplus accumulated in years when 4% dividends were not paid on the preferred stock does not belong to the common stockholders. The contract expressly provides that no dividends shall be paid on the common stock from such surplus (clause 4 above).

As to the right of the board of directors in the ordinary course of business to pay dividends on the common stock to the exclusion of the preferred from surplus accumulated in those years in which full 4% dividends *were* paid on the preferred stocks, a question has been raised on behalf of certain preferred stockholders because of the words which denominate the fund from which the directors may pay dividends on the common stock, to the exclusion of the preferred, as "surplus net profits from the business of any particular fiscal year, excluding undivided net profits remaining from previous years" (clause 3 above). This is a question which the Reading Company has never been called upon to decide, for it has never drawn upon accumulated surplus for dividends on the common stock and in the view of the Reading Company, it is not necessary to decide it now (Record, p. 182).

Whatever may be the rights of the preferred and common stocks in respect of dividends in the ordinary course of business from such accumulated surplus, it does not *belong* to the common stockholders.

The contract makes no express disposition of surplus so accumulated. Naturally, therefore, while part of the undisposed of property of the company, it is subject to the general rule which makes it the property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them, under the circumstances here obtaining; subject, however, to the right of the company, under equitable conditions, to eliminate the preferred stockholders as sharers therein by redeeming the preferred stock at par.

The decision of the board of directors as to the portion of current earnings up to 4% on the preferred stock which shall go to the preferred stock as dividends, and the portion of current earnings, after the payment of dividends of 4% to the preferred stock, which shall go to the common stock is binding, and the surplus net profits, of any year, which the board of directors has not determined to declare out for dividends, become part of the general assets of the Company which, in the case of an extraordinary distribution under the circumstances here obtaining are—as between preferred and common stockholders—subject to no preference but are distributable to them share and share alike, without discrimination and without priority or limitation of right.

As to this the determination of the board of directors is conclusive, and whatever part of the current surplus the board of directors determines

shall be retained as necessary for the conduct of the Company's business or turned back into the property for its betterment or improvement or added to its "plant" in the enlargement of those facilities in which the Company's capital is invested, becomes, by their determination and because of their determination, segregated for capital uses—uses inconsistent with a use for dividend purposes and not subject to the rules applicable to available dividend funds—and its status so lawfully created and with such a wise and prudent purpose cannot be changed without the specific and explicit determination of the board that it shall be so changed.

It cannot be fairly contended that, under the compulsion of a power superior to the Company, forcing the latter to part with a material and important part of its "plant" or its assets segregated for and devoted to capital uses, there has been, or is intended to be, either in fact or in law, any such determination by the board as is required to change that status.

VIII.

The preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation unless they are expressly preferred or limited by the terms of the contract between them.

It is the universal rule that preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation, unless

they are expressly preferred or limited in that respect by the terms of the contract between them. It is well settled that a preference as to dividends does not imply either a preference or a limitation in respect of the right to share equally in assets on liquidation or dissolution. *Birch v. Cropper (In re The Bridgewater Navigation Company Limited)*, 14 A. C. 525 (House of Lords); *Lloyd v. Pennsylvania Electric Vehicle Company*, 75 N. J. Eq., 263; *Jones v. Concord & Montreal Railroad Company*, 67 N. H. 119, 234.

In *Birch v. Cropper* (the *Bridgewater* case), 14 A. C. 525, the company issued stock expressly preferred as to dividends, but not as to assets. The articles of association contained no provision as to the distribution of assets on winding up. The Company was dissolved, and after all debts and expenses had been paid and after repaying to the stockholders the amount of capital paid up, a balance remained. It was held that this should be divided among the shareholders, share and share alike. Lord Macnaghten said at page 546:

"The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must

be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company.”

“* * * I think it rather leads to confusion to speak of the assets which are the subject of this application as “surplus assets” as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company—part and parcel of the joint stock or common fund—which at the date of the winding up represented the capital of the company. It is through their shares in the capital, and through their shares alone, that members of a company limited by shares become entitled to participate in the property of the company.”

In the case of *Lloyd v. Pennsylvania Electric Vehicle Company*, 75 N. J. Eq. 263, preferred stockholders of a New Jersey corporation, preferred only as to dividends, were paid on dissolution the full par value of their stock. The remaining assets were insufficient to pay the common stockholders in full. The court held that the assets should have been divided ratably among the preferred and common stockholders, since, when a corporation undertakes to set forth the preference to which preferred stock is entitled, instead of relying on the preference given by statute, the preference must be set forth fully, and so far as no preference is expressed, the preferred stock can have no greater rights

than the common stock. The Court said, at page 267:

"Nor is any difficulty presented where the terms of the contract entitle the preferred stockholder to a preference in dividends only. In this case, which, as Vice Chancellor Van Fleet said, and as the authorities show, was the ordinary case in the absence of such a provision as that contained in Section 86, the preferred stockholders and the general stockholders would share *pro rata* in the distribution of assets after the payment of dividends due the preferred stockholders. That such would be the rule is well illustrated by a thoroughly considered case in the English courts * * *" (*Birch v. Cropper, supra.*)

In the case of *Jones v. Concord & Montreal R. R. Company*, 67 N. H. 119, 234, the railroad company increased its capital stock and offered the new stock at par to all its stockholders ratably. The preferred stockholders were preferred as to dividends but not as to assets. A common stockholder sought to enjoin the company from offering this stock to the preferred stockholders. The Court refused the injunction on the ground that, where there was no express stipulation to the contrary, preferred and common stockholders were equal; that since the railroad company's stock was not preferred or limited as to assets, all classes of stockholders would share equally on dissolution, and that therefore they should have the right to subscribe ratably to an issue of new stock.

These cases are believed correctly to state the law everywhere. The analysis of the cases relied upon by the appellants contained in point IV of this Argument shows that they stand simply for the proposition that a limitation as to assets may be implied from an express preference as to

assets. Neither those cases, nor any other cases which have been found, at all militate against the doctrine clearly established in the cases discussed in this point VIII, that, in the absence of any express preference or limitation as to assets, no limitation as to assets can be implied from a preference as to dividends.

The Pennsylvania cases, cited and discussed under point II, *supra*, show that Pennsylvania follows the general rule in this respect.

IX.

The rights of Reading stockholders, under the Mandate of this Court directing that the combination existing and maintained through the Reading Company be dissolved and that its properties be disposed of, and under the Plan, are determined not by the rule governing dividends from current earnings, but by the rule governing the disposition of assets.

The Decree in this case involved the utter disintegration of the business for which the Reading Company was recreated and its now outstanding stock issued in connection with the reorganization of 1896.

Mr. Justice Clarke said of the scheme of reorganization (Record, pp. 8 and 9) :

"3rd. To serve the purposes of the intended Holding Company, a charter granted in 1871 by special act of the General Assembly of Pennsylvania, but unused for twenty years, was utilized. This char-

ter was of the class denominated 'omnibus' by the Supreme Court of Pennsylvania, and in terms it authorized the company to engage in, or control, almost any business other than that of a bank of issue,—this broad charter was the occasion for making use of the company in this enterprise.”

“Obviously, also, it made the Coal Company and the Railway Company mere agents or instrumentalities of the Holding Company—the mining and transportation departments of its business—for producing, purchasing, and selling coal and for transporting it to market.”

The Attorney General of Pennsylvania in his opinion dated January 2, 1897 (Record, p. 252) had said:

“Pending the foreclosure proceedings under the general mortgage made by the Philadelphia and Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company, it came to the notice of this department that a plan of reorganization was contemplated, by which it was proposed that the stock of the two companies above mentioned should be held, owned and controlled by the corporation originally known as the Excelsior Enterprise Company, since changed to Reading Company, as above mentioned.

“The obvious purpose of this part of the scheme of reorganization seemed to be to escape from that provision of the Constitution of 1874 which forbids any incorporated company doing the business of a common carrier to directly or indirectly engage in mining or manufacturing articles for transportation over its lines; or, stated differently, the union of the Coal Company with the Railroad Company.”

The annual reports for years before the reorganization had emphasized the importance of the unified ownership of the coal and railroad properties. For instance, in the annual report for 1893 it was said (Record, p. 263):

"For the last quarter of a century the maintenance of the integrity of the Reading System as a whole, and the preservation of the franchises of both the railroad and coal and iron companies so as to develop and operate the properties of both companies to advantage, have been regarded as of cardinal importance to all interested, either as creditors or as stockholders."

The Reading Company, although chartered in 1871, first became an active company in connection with the Reading reorganization in 1896 (Record, p. 2). Prior to that reorganization, its capital stock had been only \$100,000; as part of the reorganization its capital stock was increased to \$140,000,000, and, as part of the consideration for the issue of this stock, the stock of the Railway Company and of the Coal Company was transferred to the Reading Company (Record, pp. 158, 160). The Reading Company thereby became and has since continued to be a holding company, controlling two separate businesses. It is not, and never has been, an operating company. This combination of two businesses through stock ownership is the essential characteristic of the present Reading Company, the chief, if not the sole, reason for its existence (Record, p. 8), and it is this combination which the Mandate of this Court has ordered shall be dissolved (Record, p. 27).

This Court ordered the dissolution of the combination between the Reading Company, the

Railway Company and the Coal Company, etc., "with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence *from that company and from each other,*" of the Railway Company and the Coal Company, etc. (Record, p. 25). Subsequently the Reading Company made a motion to be permitted to retain either the Railway Company or the Coal Company. The motion was denied by this Court. *United States v. Reading Company*, 253 U. S. 478.

Aside from its functions as a Holding Company the Reading Company's tangible assets include only certain rolling stock and floating equipment (Record, p. 8) useless to it after compliance with the decree and indispensable to the Railway Company. Therefore, though the decree explicitly required only the disposition of the Holding Company's holdings of stocks and bonds its inevitable practical effect was to require the disposition also of its tangible assets. Mr. Justice Clark had said of the Railway Company (Record, p. 7):

"* * * But by the plan of reorganization adopted it was disabled from performing its functions as carrier, except with the aid of the Holding Company, for all of the equipment, engines, cars and ships, owned by the former Railroad Company, and its tidewater terminals at Philadelphia and on New York Harbor, were allotted to the Holding Company."

Obviously a plan which left the Holding Company the owner of the equipment would have contravened the spirit of the decision of this Court, as well as every consideration of practical expediency. The equipment would be useless to the Holding Company after dissolution and indispens-

able to the Railway Company. The decree of this Court then did really involve the utter liquidation of the Reading Company, the Holding Company.

The rights arising upon the Mandate of this Court as between the stockholders of the Reading Company are therefore those which arise in case of liquidation or dissolution. The rights became fixed by the Mandate of this Court and it became the duty of the Reading Company in formulating any plan in the execution of that Mandate to treat the rights of the stockholders *inter sese* accordingly.

Prima facie it seemed that the inevitable consequence of the decisions of this Court was to sell the stocks of the Railway Company and the Coal Company (or certificates of interest therein) or distribute them to the stockholders of the Reading Company, following the precedent established in the Northern Securities Case, (*Northern Securities Company v. United States*, 193 U. S. 197; *Harriman v. Northern Securities Company*, 197 U. S. 244, 256), modified, however to comply with the precedent established in the Union Pacific-Southern Pacific case, (*United States v. Union Pacific Railroad Company*, 226 U. S. 61, 470), so as to require the stockholders to dispose of one or the other. The consequence would have been to relieve the preferred stockholders of the Reading Company of the 4% limitation upon their participation in the earnings of the Railway Company, which the present Plan does not do; and in addition to give them full participation in the proceeds of the coal property, whereas their participation, under the present Plan, in the coal property or its proceeds is limited to the excess of its value over \$40,600,000

in cash and bonds retained in the treasury of the Reading Company. The *prima facie* plan, however, would have made it difficult to avoid disturbing the General Mortgage of the Reading Company under which \$93,000,000 of bonds, having 75 years to run, at 4%, are outstanding (Record, p. 157). The common stock would have everything to lose by such a plan, whereas the preferred would have much to gain and nothing to lose. The board of directors, however, approached the problem, not so much from the point of view of the interests of one or another class of stock as of the wise disposition of the sundered fragments of the properties. Accordingly they promulgated the present Plan, involving the merger of the Railway Company into the Reading Company and the surrender of powers inappropriate for a railroad corporation, to meet the requirements of the Mandate of this Court without disturbing the General Mortgage—a plan much less advantageous to the preferred stock.

Curiously enough it is precisely upon this feature of the Plan—the merger of the Railway Company, instead of the disposition of its stock to Reading stockholders or otherwise, followed by the usual corporate proceedings for the dissolution or reduction of capital stock of the Reading Company—a feature conceived in the interest of the conservation of the property and at the expense of the preferred stock, that the appellants really rest their case when they claim that the Plan does not involve a liquidation or dissolution of the Reading Company.

It becomes appropriate to examine just what this merger is in form and effect which the appellants rely upon to convert the consequences of this Court's dissolution decree into an extra divi-

dend for the common stock;—it becomes necessary indeed to do so for the appellants are under evident misapprehension about it.

The brief submitted on behalf of the Insurance Companies, erroneously states (p. 3) that under the Plan the Reading Company is to retain its charter. This Court has called attention to the fact that the Reading Company is a holding company having a special "omnibus" charter entitling it to engage in, or control, almost any business other than that of a bank of issue (Record, pp. 8, 20). It is not a common carrier and is not subject to regulation by Federal or State authorities having jurisdiction over railroads (Record, p. 157). It is of the very essence of the Plan, of the Government's consent and approval of it, and of the Decree of the Court below, that the Railway Company shall be merged into the Reading Company and that the Reading Company shall cease to be a holding company, surrender its extraordinary powers, and become a railroad company in all respects subject to the regulation of State and Federal authorities as a common carrier (Record, pp. 43, 277).

The merger will be made under the power contained in the charter of the Reading Company,

"* * * to merge or consolidate, or unite with the said company the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon; * * * " (Record, p. 193).

The surrender of all powers inappropriate to a railroad corporation will be made under the Pennsylvania Act of 1856, which provides as follows:

"Section 1. *Be it enacted by the Senate and House of Representatives of the Com-*

monwealth of Pennsylvania in General Assembly met, and it is hereby enacted by the authority of the same, That it shall be lawful for any court of common pleas of the proper county to hear the petition of any corporation under the seal thereof, by and with the consent of a majority of a meeting of the corporators, duly convened, praying for permission to surrender any power contained in its charter, or for the dissolution of such corporation; and if such court shall be satisfied that the prayer of such petition may be granted, without prejudice to the public welfare, or the interests of the corporators, the court may enter a decree in accordance with the prayer of the petition, whereupon such power shall cease or such corporation be dissolved: Provided, That the surrender of any such power shall not in any wise remove any limitation or restriction in such charter; and that the accounts of the managers, directors, or trustees of any dissolved company shall be settled in such court, and be approved thereby; and dividends of the effects shall be made among any corporators entitled thereto, as in the case of the accounts of assignees and trustees: Provided further, That no property devoted to religious, literary, or charitable uses shall be diverted from the objects for which they were given or granted: Provided, That the decree of said court shall not go into effect until a certified copy thereof be filed and recorded in the office of the secretary of the commonwealth." (Laws of Pennsylvania, 1856, p. 293, No. 308).

The acceptance of the Constitution of the State of Pennsylvania will be made under the Pennsylvania Act of 1874 which provides as follows:

"Section 1. *Be it enacted, etc., That it shall be the duty of the board of direc-*

tors of any railroad, canal or other transportation company in existence on the first day of January, one thousand eight hundred and seventy-four, desiring to accept of the provisions of the seventeenth article of the constitution of the state, adopted on the sixteenth day of December, one thousand eight hundred and seventy-three, to file in the office of the secretary of the commonwealth a certificate in writing, signed by the president and secretary, and attested by the corporate seal of the company, stating that at a regular or special meeting of said board of directors a resolution, in pursuance of the consent of the stockholders, was adopted, accepting of all the provisions of said article; and all the powers and privileges, and the limitations and restrictions mentioned therein, shall be deemed and taken for all purposes to apply to said corporation; the said certificate shall be recorded in the office of the secretary of the commonwealth, in a suitable book to be by him kept for that purpose."

"Section 2. No such certificate shall be made by the officers aforesaid, without the consent of the stockholders of the corporation, to be obtained by an election to be held in the same manner as prescribed by law for increasing the capital stock of a corporation." (By the consent of a majority of the stockholders.) (Laws of Pennsylvania 1874, p. 275, No. 157).

After such action the company formed by the merger will have no powers except those granted to railroad companies incorporated under the general laws of Pennsylvania.

Under the law of Pennsylvania whenever there is a union of two or more corporations, the resulting corporation is a new corporation, distinct from any of the original corporations. This is

true whether the union be called a merger or a consolidation; the two terms are interchangeable. *Lauman v. The Lebanon Valley Railroad Company*, 30 Pa. St. 42; *Dalmas v. Philipsburg & Susquehanna Valley Railroad Company*, 254 Pa. St. 9; *Pennsylvania Utilities Company v. Public Service Commission*, 69 Pa. Sup. Ct. 612.

The case of *Lauman v. The Lebanon Valley Railroad Company*, 30 Pa. St. 42, was a bill to enjoin The Lebanon Valley Railroad Company from merging with the Philadelphia and Reading Railroad Company, under a special Act of Assembly which gave them power to merge. The Court said on page 45:

"This is called a merger of the Lebanon corporation into the other; but such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved."

In the case of *Dalmas v. Philipsburg & Susquehanna Railroad Company*, 254 Pa. St. 9, the Court discussed merger under various acts, including the Merger Act of 1865. An interpretation of the word merger as used in these acts passed both before and after the Charter of the Reading Company is an aid in the construction of the legislative intention in the use of the words "merge" and "consolidate" in that Charter. The lower court (its opinion was adopted by the upper court, which affirmed the decision without an opinion), said on page 15:

"When two or more corporations merge, the presumption is that all of the property of each constituent company is transferred to and becomes the property of the new company, and that from the time of the completion of said merger the constituent companies cease to exist so far as the terms of the act of assembly, under which

said merger is effected, preserve their existence; and in order to overcome this presumption there must be a saving clause in the merger proceedings. No such saving clause appears in this bill."

There is no such saving clause in the Charter of the Reading Company (Record, p. 189).

In the case of *Pennsylvania Utilities Company v. Public Service Commission*, 69 Pa. Sup. Ct. 612, the lower Court cites *Lauman v. The Lebanon Valley Railroad Company* with approval in discussing the Merger Act of 1909, Pennsylvania Laws, p. 408, No. 229, which provides:

"Section 1. Be it enacted, &c., That it shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made."

The Court said, page 618:

"It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from

that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: * * *

The Reading Company will thus be deprived, by the decision of this Court, and the execution of the Plan, of its properties, its corporate powers, its corporate existence even. Though the proceedings take the form of a merger by the Holding Company of the Railway Company, a new corporation will result from these proceedings, and that not a holding company but a railroad company.

Having regard then to the purposes for which it was formed, or reformed, in 1896, to its status and its corporate history as a holding company organized and operated (in the words of Mr. Justice Clarke—Record, p. 9) “for producing, purchasing, and selling coal and for transporting it to market” through the railroad and coal companies as its agents or instrumentalities, “the mining and transportation departments of its business”; having regard also to the utter disintegration of this business which the decree directs and the Plan effects, and to the termination of the corporate powers and the very corporate existence of the condemned holding company; it is apparent that the decree directs and the Plan effects not only a technical, but also a very complete and practical dissolution of the Reading Company.

The Reading Company believes that the rights of its stockholders in the situation created by the direction of this Court “dissolving the combination * * * existing and maintained through the Reading Company” and directing that its

properties be disposed of, and under the present Plan which carries out the Mandate of this Court, are determined, not by the rule governing dividends from current earnings, but by the rule governing the disposition of assets.

Conclusion.

The Decree of the District Court approving the Plan should be affirmed.

Respectfully submitted,

CHARLES HEEBNER,
R. C. LEFFINGWELL,
WM. CLARKE MASON,
L. D. ADKINS,
A. I. HENDERSON,
Of Counsel.

CONTINENTAL INSURANCE COMPANY ET AL. *v.*
UNITED STATES, READING COMPANY, ET AL.

PROSSER ET AL., AS A COMMITTEE REPRESENT-
ING HOLDERS OF COMMON STOCK OF THE
READING COMPANY, *v.* UNITED STATES,
READING COMPANY, ET AL.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Nos. 609, 610. Argued January 18, 19, 1922; restored to docket for reargument February 27, 1922; reargued April 10, 11, 1922.—Decided May 29, 1922.

1. Upon an appeal under the Expedition Act of February 11, 1903, as modified by Jud. Code, § 291, from a decree entered under a mandate of this court directing the dissolution of a combination in restraint of interstate trade, this court has jurisdiction, of its own motion and independently of the assignments of error, to determine whether the mandate has been properly complied with and to require such compliance. P. 165.
2. A plan decreed by the District Court (summarized in the opinion, *post*, 166,) for dissolving the combination adjudged unlawful in *United States v. Reading Co.*, 253 U. S. 26, *approved*, in so far as it provides: for merging the Philadelphia & Reading Railway Company in the Reading Company, shorn of corporate capacity to do other than a railroad business; for separating the Central Railroad Company of New Jersey from the Reading Company by sale or disposition of the shares of the former held by the latter (p. 175); for separating the Lehigh & Wilkes-Barre Coal Company by sale of its stock held by the Central Railroad Company of New Jersey (p. 175); and for separating the Reading Company from the Philadelphia & Reading Coal & Iron Company by transfer of all the stock of the latter (held by the former) to a new coal company, to be organized by trustees of the court, the stock of which shall be issued under conditions assuring that those who acquire it shall not be interested in the Reading Company;—but *disapproved*, in so far as it leaves the capital stock and properties of the Philadelphia & Reading Coal & Iron Company subject to the lien of an out-

standing general mortgage covering also much of the property of the Reading Railway Company, payment of which, as between these two, is assumed by the Reading Company, and in so far as it provides that the Philadelphia & Reading Coal & Iron Company shall give a new mortgage of all its property to secure bonds to be delivered by it to the Reading Company in the adjustment of their financial relations. P. 167.

3. The court has power under the Sherman Anti-Trust Act, in dissolving a combination of two corporations, to disregard the letter and legal effect of a general mortgage of their properties and of the bonds secured thereby, in order to achieve the purpose of the act. P. 171. *United States v. Southern Pacific Co.*, post, 214.
4. In this case, the general mortgage of the Reading Company and the Philadelphia & Reading Coal & Iron Company gave notice on its face of the unlawful union and purpose of which it was the necessary instrument, and those who took the bonds thus secured, although they may have done so innocently, relying on legal advice and surrendering valid underlying liens created before the Sherman Act, hold them subject to the judicial power to free the two properties from the consolidating tendency of the mortgage by relieving one of them from the lien and substituting a judicial equivalent in protection of the bondholders. P. 171.
5. The decree in this case should modify the liability under the general mortgage and bonds so that the obligation of each mortgagor company upon the bonds, and the lien upon its property, shall be reduced to an amount proportionate to the ratio of the value of its property subject to the mortgage to the value of all the property so mortgaged, and should make specific provisions for foreclosure of the resulting separate liens in case of default. P. 173.
6. Any injury to the security caused by this modification of the terms of the debt and mortgage may be compensated by such payment to the bondholders, by either or both mortgagor companies, as may seem equitable and convenient. P. 174.
7. Authority is given the District Court to amend the plan of dissolution for the purpose of leaving the Reading Company properly financed, and to make such detailed changes as, after full hearing of all the parties, it may find practically necessary in following the general outlines of the modifications here made. P. 174.
8. The decree should provide not only that all stockholders of the new coal company, upon receiving and registering their stock, shall make affidavits that they are not owners or the agents or representatives of owners of stock in the Reading Company, but also

should require the merged Reading Company to adopt a by-law, effective until the further order of the court, permitting registration of transfers of its stock only in the names of persons who make affidavit that they are not stockholders of the new or old coal companies and have not been and are not holders of proxies to vote shares therein. P. 175.

9. The plan of dissolution provides that the stock of the new coal company shall be disposed of primarily by sale to the preferred and common stockholders of the Reading Company, share and share alike, of assignable certificates exchangeable for the new coal company's shares by holders who prove at the time that they are not stockholders or representing stockholders of the Reading Company or in any agreement in its interest for the control of the coal company. *Held:*

(a) That the so-called sale is in effect a distribution of forbidden surplus assets of the Reading Company to its stockholders, small payments being required for the purpose of providing the company with additional capital for the operation of its railway system. P. 176.

(b) That the distribution as between the preferred and common stockholders must be determined by the organization agreement of the Reading Company defining their rights and must be *pro rata*, whether under that agreement the net profits of any past year, after paying preferred shareholders their full percentage, may be divided among the common stockholders or not, since the declaring of any dividend is left to the honest discretion of the board of directors, and undivided profits are to be regarded as capital assets and distributed on liquidation, the board not having applied them as dividends. P. 177.

10. It is a general rule that stockholders, common and preferred, share alike in the assets of a liquidating corporation, if the preference be only as to dividends. P. 181.

11. Whether, under the federal Commodities Clause and the Constitution of Pennsylvania, it will be proper and lawful that the Reading Company, becoming reorganized as a railroad corporation, continue to own stock of the Reading Iron Company, an iron manufacturing concern, will be determined, and the plan of dissolution modified accordingly, by the District Court. P. 181.

273 Fed. 848, affirmed with modifications.

This case presents the questions, first whether a decree of the District Court entered under a mandate from this

court in *United States v. Reading Co.*, 253 U. S. 26, is in accordance therewith, and second, whether it does equity to the appellants.

The original suit was instituted by the United States to dissolve the relation existing between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, all corporations of Pennsylvania, the Central Railroad Company of New Jersey, a corporation of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, a corporation of Pennsylvania, as a combination to restrain and monopolize interstate commerce in anthracite coal, and to violate the Commodities Clause of the Act of June 29, 1906, c. 3591, 34 Stat. 585.

This court found that by a scheme of reorganization, adopted in December, 1895, the Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company combined to deliver into the complete control of the board of directors of a holding company, the Reading Company, all of the property of much the largest single coal company operating in the Schuylkill field, and almost one thousand miles of railway over which its coal must find its access to interstate markets, and that this constituted a combination unduly to restrain and monopolize interstate commerce in anthracite coal; that the Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company had thereafter but one stockholder, the Reading Company, and that thus the Reading Company served to pool the property, the activities and the profits of the three companies. The court further found that through the acquisition by the Reading Company of a majority of the stock of the Central Railroad Company of New Jersey which itself owned 90 per cent. of the stock in the Lehigh & Wilkes-Barre Coal Company, the illegal power of the combination was greatly increased, and that the relation of common control through

stock ownership of the Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company, and that of the Central Railroad Company of New Jersey and the Lehigh Valley & Wilkes-Barre Coal Company were violations of the commodities clause, requiring dissolution. The court, therefore, remanded the case to the District Court directing a decree in conformity to the opinion dissolving the whole combination of the four companies with the Reading Company and such disposition of the shares of stocks and bonds and other property of the Reading Company as might be necessary to establish the entire independence of each company from the others, to the end that the affairs of all of them might be conducted in harmony with law.

For convenience the Philadelphia & Reading Railway Company will be called the Reading Railway Company, the Philadelphia & Reading Coal & Iron Company the Reading Coal Company, the Central Railroad Company of New Jersey the New Jersey Railroad Company, and the Lehigh & Wilkes-Barre Coal Company the Wilkes-Barre Coal Company.

The situation at the time the District Court was directed to enter its decree was as follows: The Reading Company, the holding company, had a special charter under the laws of Pennsylvania granted prior to the adoption of the constitution of that State of 1874, with unusually broad powers. It was not engaged directly in operating a railroad and was not subject to regulation by federal or state authorities having jurisdiction over common carriers. It owned the entire capital stock of the Reading Railway Company, being \$42,481,700 par value, and \$20,000,000 of its bonds; \$8,000,000, par value, being the entire capital stock of the Reading Coal Company; the real estate, rolling stock and floating equipment used upon or in connection with the Reading Railway System; shares of stock and bonds of other railroads and terminal companies, con-

stituting a part of the Reading Railway System; \$14,504,000, par value, being more than a majority, of the stock of the New Jersey Railroad Company, all of which was pledged except forty shares under a collateral trust mortgage to secure \$23,000,000 worth of bonds. These were not all its holdings, but they are all that are important here.

On January 5, 1897, the Reading Company and the Reading Coal Company jointly gave a mortgage to the Central, now the Central Union Trust Company of New York, trustee, hereafter to be referred to as the general mortgage. The security under this mortgage was all the property of the Reading Coal Company and all of its capital stock, together with all of the capital stock of the Reading Railway Company and all the railroad equipment and certain real estate essential to the operation of the Reading Railway Company, which was held by the Reading Company, together with certain bonds of the Railway Company. The bonds now outstanding under this mortgage amount in round figures to \$93,000,000.

A combination of the Reading Railway Company and the Reading Coal Company had been maintained for years and the property of the Reading Coal Company had been greatly enlarged by purchases and improvements through money advanced by the Reading Railway Company, resulting in an indebtedness of the Reading Coal Company to the Reading Railway Company which ultimately amounted to about \$70,000,000. In 1896, when the Reading Company became the holding company under the then formed combination, this indebtedness of the Coal Company to the Railway Company appeared as a credit on the books of the Reading Company, and a debit on the books of the Coal Company, but it is quite clear that they were mere bookkeeping entries and that it had been agreed that they should be canceled. They are canceled in the proposed plan.

Under the plan embodied in the decree of the District Court, the Reading Company is as between it and the Reading Coal Company to assume the whole liability under the general mortgage, and agrees to save the Coal Company and its property harmless therefrom. The Reading Company is to receive from the Reading Coal Company \$10,000,000 in cash or current assets, and \$25,000,000 in 4 per cent. bonds of the Reading Coal Company, secured by mortgage on its properties. The Reading Company is to transfer its interest, subject to the lien of the general mortgage, in all the stock of the present Reading Coal Company, amounting to eight million dollars in par value but actually worth many times that amount, including the right to vote and receive dividends thereon, to a new Reading Coal Company, a corporation to be created under the supervision of the District Court, and over which that court is to retain control so as to prevent its being used to thwart the decree.

The new Coal Company agrees to issue as its total capital stock 1,400,000 shares without par value, to a trustee or trustees appointed by the District Court, who are to transfer to the Reading Company assignable certificates of interest in the stock of the new Coal Company, for distribution to its stockholders. The certificates are to be exchangeable for such stock only when accompanied by an affidavit, stating among other things that the holder is not an owner of any stock of the Reading Company and is not acting for or on behalf of any stockholder of the Reading Company, or in concert, agreement or understanding with any other person, firm or corporation for the control of the Coal Company in the interest of the Reading Company, but in his own behalf in good faith.

The certificates of interest are to be offered for so-called sale by the Reading Company to its stockholders, preferred and common, share and share alike, for \$2.00 for each share of the Reading Company. Such stockholders

can not, however, continue as stockholders of the Reading Company and become stockholders of the new Coal Company during the conversion period, but each must dispose of his certificates of interest in the new Coal Company or of his stock in the Reading Company. If, after July 1, 1924, any of the certificates shall remain outstanding, the court in its discretion and after a hearing may order the shares covered by such certificates to be sold and the proceeds distributed to the owners of such certificates. The Attorney General is given access to the transfer books of both companies to enforce compliance with the order. This secures to the Reading Company in cash \$5,600,000.

Second: The Reading Company will merge into itself the Reading Railway Company and all the railway property of the Reading Railway Company is to be made subject to the direct lien of the general mortgage. The existing charter of the Reading Company authorizes such a merger. The Reading Company is to accept the Pennsylvania constitution of 1874, and to proceed under the Pennsylvania Act of 1856 to surrender those of its franchises which are inappropriate for a railroad corporation of Pennsylvania. It will thus become a railway company subject in all respects to the regulation of the state and federal authorities as a common carrier.

Third: The Reading Company is to transfer to trustees appointed by the District Court, subject to the lien of the collateral trust mortgage already mentioned, all of its interest in the stock of the New Jersey Railroad Company. The final disposition of this stock is to be deferred in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, but is to be subject to an order of sale by the court in its discretion before that time. The trustees are directed to select directors and secure a management of the New Jersey Railroad Company entirely independent of

the Reading Company, which shall discharge its duties under the supervision of the court.

Fourth: The stock of the Wilkes-Barre Coal Company, held by the New Jersey Railroad Company is by the decree to be sold to persons not stockholders of the New Jersey Railroad Company, the Reading Company, the Reading Railway Company, or the new Reading Coal Company, and who shall qualify as purchasers of the same by an affidavit like the one already mentioned. It appears that this provision of the decree has already been carried out because not appealed from, and that the stock of the Wilkes-Barre Coal Company has been sold, though there is pending an application to set the sale aside.

The appeals in this case were taken by the Insurance Companies, who own 8,400 shares of the common stock of the Reading Company, less than one per cent. of the entire common stock, and by the so-called Prosser Committee, also interveners, who represent 407,728 shares of the common stock, which is somewhat less than 30 per cent. of the total common stock, and less than 15 per cent. of the entire capital stock of the Company. Their appeals are based on the claim that the right to subscribe for the certificates of interest in the stock of the new Coal Company belong to the common stockholders of the Reading Company and to them alone, to the exclusion of the preferred stockholders.

After the first argument of these appeals, the court directed a second argument upon the questions (1) whether the plan adopted by the District Court was in conformity with this court's mandate, in establishing the entire independence of the companies found in unlawful combination from each other, (2) whether there was any legal or practical difficulty in selling the Reading Coal Company's stock free from the lien of the general mortgage, and (3) what was the basis of the adjustment of the indebtedness between the Reading Company and the new and old Reading Coal Companies. [257 U. S. 622.]

156.

Opinion of the Court.

Mr. R. C. Leffingwell, with whom *Mr. Charles Heebner*, *Mr. Wm. Clarke Mason*, *Mr. L. D. Adkins* and *Mr. A. I. Henderson* were on the brief, for the Reading Company.¹

Mr. John M. Perry, with whom *Mr. Arthur H. Van Brunt* was on the brief, for Central Union Trust Company of New York.

Mr. Alfred A. Cook, with whom *Mr. Frederick F. Greenman* and *Mr. Robert Szold* were on the brief, for appellants in No. 609.

Mr. George W. Wickersham, with whom *Mr. Edwin P. Grosvenor* was on the brief, for Iselin et al., a committee representing preferred stockholders.

Mr. Joseph M. Hartfield, with whom *Mr. Roberts Walker*, *Mr. J. DuPratt White* and *Mr. Allen McCarty* were on the briefs, for appellants in No. 610.

Mr. Solicitor General Beck, with whom *Mr. Attorney General Daugherty*, *Mr. Assistant to the Attorney General Goff* and *Mr. Abram F. Myers*, Special Assistant to the Attorney General, were on the brief, for the United States.

MR. CHIEF JUSTICE TAFT, after stating the case as above, delivered the opinion of the court.

The appeals which brought this case here were taken under the Act of Congress approved February 11, 1903, c. 544, 32 Stat. 823, as modified by § 291 of the Judicial Code. Ordinarily the scope of our review of the decree of

¹At the former hearing, arguments were made, on behalf of Joseph E. Widener, appellee, and on behalf of William B. Kurtz et al., appellees, by *Messrs. Ellis Ames Ballard* and *Thomas Raeburn White*, respectively. No argument was made by the *Solicitor General* or on behalf of the Central Union Trust Company. For the order restoring the case for reargument, see 257 U. S. 622.

the District Court would be limited to the assignments of error of the appellants, but in this case, as the decree which is before us was entered under a mandate of this court, we have jurisdiction to consider on our own motion whether our mandate has been complied with. We delegated to the District Court the duty of formulating a decree in compliance with the principles announced in our judgment of reversal, and that gives us plenary power where the compliance has been attempted and the decree in any proper way is brought to our attention to see that it follows our opinion.

The plan of dissolution of the bond between the four companies under the control of the holding company is, shortly, as follows:

1. It merges the Reading Railway Company in the Reading Company and shears the latter of corporate capacity to do other than a railroad business.

2. It turns over to trustees of the court for sale or disposition in accord with the plan of groupings by the Interstate Commerce Commission to be adopted under the Transportation Act the majority stock of the New Jersey Railroad Company.

3. It separates the Wilkes-Barre Coal Company from the New Jersey Railroad Company by directing the sale of that stock to persons who do not own stock in any of the other companies.

4. It separates the Reading Company from the Reading Coal Company by a transfer of all the stock in the latter company to a new coal company to be organized by trustees of the court, and directs a distribution to the stockholders of the Reading Company, in proportion to their respective holdings of stock in the latter company, of valuable rights, evidenced by so-called certificates of interest, to dispose of the stock in the new Coal Company. The effect of the decree is to require them either to sell these certificates to others not stockholders in the Read-

ing Company, or to sell their stock in the Reading Company before themselves becoming stockholders in the new Coal Company, or doing neither, and receiving no interest in the interval, to let the court sell the new stock after July 1, 1924, for their account.

The difficulty in the separation of the interests of the Reading Company and the Reading Coal Company is that the lien of the general mortgage covers much of the property of the Reading Company and all of the stock and property of the Coal Company and is not redeemable until 1997. The plan requires the Reading Company to assume the whole liability of the general mortgage and to save the old and new Coal Companies harmless therefrom in consideration of \$10,000,000 cash or current assets and \$25,000,000 in bonds secured by mortgage on all its property by the Reading Coal Company, redeemable at the same time as the general mortgage. This is on the assumption in which all agree that the respective liabilities of the Reading Company and the Coal Company under the lien of the mortgage as between themselves should be regarded as something less than three to one.

The doubt whether the plan is adequate to secure the object of this court has been prompted by the failure to take out from under the lien of the general mortgage the capital stock and the properties of the Reading Coal Company and the giving of a new mortgage by the Reading Coal Company on all its property to secure bonds to be delivered by it to the Reading Company. The query is whether this would not leave in the Reading Company some possible measure of future control over the Coal Company and enable the Reading Company later on to reestablish in effect the combination which, this court decided, must be ended.

It is further questioned whether the interest which the new Coal Company, with its properties still subject to the lien of the general mortgage, will have in preserving the

solvency of the Reading Company, would not create a constant motive on its part to favor the Reading Company with its tonnage and discriminate against other carriers reaching its mines. It is pointed out, too, that the interest of the Reading Company in the continuing ability of the Coal Company to avoid default on its proposed mortgage for \$25,000,000 to secure bonds to be given to the Reading Company, would prompt a community of operation between the two companies which it was the object of this court to end.

All these difficulties, it is said, could be removed if all of the properties and stock of the Coal Company were sold outright and the purchase money applied to the satisfaction *pro tanto* of the general mortgage by depositing with the trustee cash or current securities equal to one-third of the amount of the general mortgage debt, as the fair ratio of the Coal Company's contribution to the security of that company, the remainder of the proceeds of sale to go to the Reading Company for its proper disposition as assets of its own.

When the mandate went down, the District Court invited the Reading Company to propose a plan for the dissolution of the illegal combination for submission to all the parties in interest, including, of course, the Government. The first form of plan contemplated that the release of the stock and properties of the Reading Coal Company from the lien of the general mortgage should be secured by the Reading Company's paying to each bondholder, in consideration of his release, a cash premium of ten per cent. of the par value of the bonds he held. This did not meet with the favor of the bondholders or of their trustee. The common stockholders of the Reading Company also objected. The Solicitor General in his discussion of the plan put the case thus:

"The Attorney General, therefore, was confronted with these alternatives: (1) To insist upon the court ordering

the release of the stock and properties of the Reading Coal Company from the lien of the general mortgage without the consent and over the protest of the trustee and the bondholders; or (2) To assent to a modification of the plan which, while placing in different hands the stock control of the Reading Company and the Reading Coal Company and providing effective safeguards against future inter-corporate relations, would leave the stock and properties of the latter pledged under the general mortgage.

"The following considerations appeared to make the latter course the wiser as well as the more expedient:

"(1) The attitude of the trustee and bondholders made it clear that the former course would meet with an opposition which certainly would have resulted in another appeal to this court with consequent delay in effecting a dissolution."

The fourth reason was stated as follows:

"(4) Finally, and most important, the country at that time was in the midst of a serious financial and industrial depression accompanying the transition from the artificial stimulations of war to normal conditions of peace. The condition was regarded as critical. Grave apprehension was felt that if the Government should insist upon the disruption of the general mortgage public confidence in the restoration of prosperity might be adversely affected. It seemed the course of wisdom, therefore, to avoid the possibility of contributing further to an already threatening situation if it could be done without sacrifice to the effectiveness of the dissolution. The Government was not averse to any necessary surgery, but it seemed wise not to amputate any more than was necessary to secure the great policy of the Sherman law. In this it followed the admonition of this court in the *Standard Oil and Tobacco Cases* that innocent interests, as the present holders of the bonds in question were, should be spared unnecessary injury."

It is asserted further by the Reading Company, and not denied, that, when this decree was entered by the District Court, the monetary situation was such that it would have been impossible to secure a purchaser of the Reading Coal Company properties at any fair price, that indeed the transaction could not have been financed at all.

The considerations influencing the District Court and the Government against a drastic readjustment of the interests of the bondholders under the general mortgage and the holdings of the two offending companies were of manifest weight in the then business and monetary situation. Even now this court would hesitate to order a sale of this kind of property worth probably one hundred million dollars with confident hope of realizing an adequate amount with the necessary restrictions as to the purchaser. We agree with the Attorney General in his disinclination to insist upon such a sale under the circumstances. Since the time of settling the decree, however, a change for the better has come in the financial situation. We think that this justifies us now in making some modifications in the plan which were not presented to the parties or considered by the court, possibly because they might have been unwise in the critical conditions then existing. They involve a departure from the contract provisions of the general mortgage and the bonds it secures.

The petition of the trustee under the general mortgage urges that a court of equity ought not by its decree, summarily to wrench the Coal Company's property from under the pledge of the mortgage, or to vary its terms in view of the circumstances. It points out that neither the trustee nor the bondholders were made parties to the original bill to set aside the combination and monopoly, and that the trustee was made a party to the proceeding only after the mandate of this court went down. The petition avers the innocence of any wrongdoing on the part of the bondholders, and alleges that, of the \$106,-

000,000 of bonds issued, \$50,000,000 were issued at or about the date of the mortgage in 1896, \$36,000,000 were issued between 1897 and 1920 to take up and in exchange for underlying bonds that were liens prior to reorganization and for the most part prior to the passage of the Sherman Act, and \$20,000,000 were issued between 1898 and 1911 for betterments. It further alleges that for twenty years after this mortgage was executed, its validity, as far as the bondholders are concerned, has not been questioned by the Government and these bonds have passed into the hands of numerous and widely scattered holders, that few of them, if any, are or were identified at all with the management of the Reading Company or Coal Company, and many of the bonds are held by fiduciaries.

The power of the court under the Sherman Anti-Trust Law to disregard the letter and legal effect of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law, we can not question. The principles laid down and followed in the case of *United States v. Southern Pacific Co.*, decided today, *post*, 214, leave no doubt upon this point. Indeed, the case which we there cite, *Philadelphia, Baltimore & Washington R. R. Co. v. Schubert*, 224 U. S. 603, 613, 614, is a stronger instance of the power of Congress in regulating interstate commerce to disregard contracts than is needed in this case, because there it was enforced as to a contract made before the regulation. It may be conceded, as averred, that the bondholders in this case were innocent of any actual sense of wrongdoing, that they relied on the advice of eminent counsel in assuming that the union of the Railroad and the Coal Companies under the control of the holding company was not a violation of the Sherman Law, and that some of them surrendered bonds secured by underlying liens of unquestioned valid-

ity created before the enactment of the Sherman Law. Nevertheless, spread all over the face of the general mortgage, was the information and notice of the union of the railway and coal properties for the very purpose which is the head and front of the offending under the Anti-Trust Law and which requires this court to dissolve the illegal combination. The general mortgage was the indispensable instrument of the unlawful conspiracy to restrain interstate commerce. It was the advantage of the legally improper relation between the railway and coal interests which made the security so attractive. In one of the phases of a case, reported as *United States v. Lake Shore & M. S. Ry. Co.*, 203 Fed. 295, the Court of Appeals of the Sixth Circuit was obliged to consider on an intervening petition, the question of the power of the court under the Sherman Act to deal with a mortgage whose lien if held to be inviolable interfered with the effective dissolution of the offending combination of a railway company and a coal company. The opinion is not reported, but we have been furnished a certified copy of the memorandum opinion and its language is so pertinent that we quote it as expressing our view:

“ One who takes a mortgage upon several items of property of such character that their common ownership or operation may offend against the Anti-Trust Law or the commodities clause, and such that the mortgage serves practically to aid in tying them together, must be deemed to hold his mortgage subject to the contingency that if the complete and final separation of one item of the mortgaged property from the remainder becomes essential to the due enforcement of either named law, the court charged with such enforcement may take control of that item, free it from the consolidating tendency of the mortgage, and substitute therefor its judicially ascertained equivalent. Otherwise the mortgage will stand as the ready means of restoring—or at least tending to restore—

those conditions which the court is endeavoring to destroy. It may well be true that a railroad and a coal company under common ownership and management are worth more as security under a mortgage than when independent, and that their effective separation does impair the mortgage security, but this can not make the law helpless."

We have no desire to vary the security of the bondholders more than seems necessary to effect fully the purpose of the law, and wish to recognize their equities as against the two companies and the stockholders, as will later appear.

We think that the plan should be changed in accord with the following suggestions. The District Court should, after a hearing of all interested parties, determine the respective values of the properties of the merged Reading Company and the Coal Company which are subject to lien of the general mortgage. Then the decree should direct that the liability of each on the bonds and the pledge under the mortgage shall be modified as between the mortgagee and the mortgagors, so that the liability of the Reading Company on the bonds outstanding, and the lien of the mortgage upon that company's property to secure them, shall be reduced to an amount proportionate to the ratio of the value of its pledged property to the value of all the property pledged including that of the Coal Company. The obligation of the Coal Company upon such bonds and the lien upon its property to secure them should be reduced in corresponding proportion. The amount that each company is to pay as interest should be similarly fixed, and specific provisions for foreclosure of these separate liens on default and requisite machinery and other necessary changes to carry out the result will be made by the District Court in its discretion. By this arrangement the interests and joint obligations of the Reading Company and the Coal Company will be completely severed and the purpose of this court carried out.

The Reading Company's first plan contemplated the securing of a voluntary release of the Coal Company's property by the bondholders through payment of ten per cent. of the par value of his bonds to each bondholder; but the proposal did not meet with favor. We leave it to the District Court to determine what, if any, injury to the security this modification of the terms of the debt and mortgage may cause and to compensate for it by such a payment to the bondholders by either or both companies as may seem equitable and convenient.

The changes involved in these suggestions may interfere with, or make inapplicable, the provisions of the present plan looking to a proper working capital for the Reading Company. Authority is therefore given to the District Court to amend the plan in any way which seems wise to leave the Reading Company properly financed to meet its obligations to the public.

It does not seem necessary to change the general form of that feature of the plan by which, through the distribution of certificates of interest to the stockholders of the old Reading Company in the stock of the new Coal Company, the stock relations of the old Reading Company and the present Coal Company are to be ended, though we would not limit the power of the District Court in this regard. It may be found necessary to increase the price of two dollars per share in the Reading Company which the recipients of the certificates of interest in the stock of the new Coal Company are to pay therefor, in order to reserve more cash to the Reading Company in that transaction; but this the District Court can determine. The adopted plan was nicely adjusted to secure a practical working basis for both companies, and we would not embarrass the District Court, after a full hearing of all the parties, in the detailed changes which it may find practically necessary to adopt in following the general outlines of our modification of the plan.

We think it not unreasonable to accept the suggestion made at the bar, namely, that not only shall the stockholders of the Coal Company upon receiving and registering their stock be required to make affidavit that they have no stock ownership in the Reading Company and are not acting for, or representing, anyone who has, but also that the merged Reading Company shall be required to adopt a by-law effective till the further order of the court permitting registration of transfers of shares of its capital stock in the names only of persons who shall make affidavit that they are not stockholders, registered or actual in either the new or the old Coal Company, and have not been and are not holders of proxies to vote shares of stock therein.

As to the New Jersey Railroad Company and the Wilkes-Barre Coal Company, we have heard no criticism and the provisions as to them are approved. By the decree, the new Coal Company, its officers and directors are enjoined from voting the Coal Company stock so as to form a combination between the Coal Company and the Reading Company. The Reading Company and all persons acting for or in its interest are perpetually enjoined from acquiring, receiving, holding, voting, or in any manner acting as the owner of any shares of the new Coal Company; and the new Coal Company and all persons acting for it are enjoined from acquiring, or voting, any of the shares of the Reading Company. The Coal Company will be permanently enjoined from issuing to the Reading Company, and the Reading Company from receiving, any stock, bonds, or other evidences of corporate indebtedness of the Coal Company. On default the trustee of the mortgage is required to vote the Coal Company stock so as not to bring about a recurrence of the conditions condemned in this cause, and if it shall be necessary to sell the properties they are to be sold to different interests. The Attorney General and his successors in office

are given by the decree full opportunity to keep a watch upon the relations between the two companies and to appeal to the court for prompt enforcement of the injunctions of the decree as they may be advised. The court retains large control of the decree with power to assure its continued efficacy by the summary remedy of contempt. With these restrictive provisions and the modifications of the plan outlined above, we think that the independence of the four companies will be fully achieved.

We come now to the issue upon which these appeals were brought here. It concerns the respective rights of the common stockholders and the preferred stockholders in the assets of the Reading Company. They all, under the plan, will receive the benefit of the difference between the real value of the privilege of disposing of their distributive certificates of interest in stock in the new Coal Company, and the payment of \$2.00 or such other sum as may be fixed, per share held by them of the Reading Company stock. Such difference has already been the subject of sale and quotation on the market in New York and has varied from \$11 to \$20. This might have been expected in view of the disparity between par of the capital stock of the Reading Coal Company and the far greater actual value of its properties. The disparity shows that while the transfer of certificates of interest in the new Coal Company stock is denominated a sale, it is only a distribution of the surplus or assets of the Reading Company to its stockholders made necessary by the decree of this court in taking the Reading Company out of the coal business and restricting it to that of owning and operating a railroad system. The Reading Company by merger with the Reading Railway Company is made to change its character. Under the plan it must comply with the Act of May 3, 1909, Penn. Laws, 408, by which, in merging with the Reading Railroad Company, it becomes a new corporation. *Pennsylvania Utilities Co. v. Public Service Commission*,

69 Pa. Super. Ct. 612; *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42, 45; *Clearwater v. Meredith*, 1 Wall. 25; *Railroad Co. v. Georgia*, 98 U. S. 359; *Yazoo & Mississippi Valley Ry. Co. v. Adams*, 180 U. S. 1; *Shields v. Ohio*, 95 U. S. 319.

What is to be done is in fact and law a liquidation of the assets of the old Reading Company. Its stockholders receive their distribution in kind by retention of the stock they held in the old Reading Company as stock in the reduced new Reading Company, purged of its offense against the law, together with the distributive values of that which the old Reading Company has been compelled to get rid of, *i. e.*, the ownership of the stock of the Coal Company. The distribution of certificates of interest in the new Coal Company shares was evidently given the form of a sale to enable the new Reading Company to realize out of it \$5,600,000 in cash to give it additional working capital enough properly to operate the Reading Railway System. But this does not change its real nature as a mere distribution of forbidden assets in kind to stockholders.

The rights of the common and preferred stockholders of the Reading Company *inter sese* are to be determined by the organization agreement of 1896. At that time, under a special charter of a corporation known as the Excelsior Enterprise Company granted by the Pennsylvania Legislature in 1871, the Reading Company, by change of name, came into being. The capital stock was increased to \$140,000,000 divided into 2,800,000 shares of the par value of \$50 each. Half of these were preferred, \$28,000,000 first preferred, and \$42,000,000 second preferred. The other half or \$70,000,000 were common, and the rights of the preferred and common stock were fixed by agreement. Each share of stock, whether common or preferred, had a vote. The agreement provided that the preferred stock should be entitled to non-cumulative dividends "at the

rate of, but not exceeding, four per cent per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year, of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

The company was given the right at any time to redeem either or both classes of its preferred stock at par in cash, if such redemption should then be allowed by law and after payment of dividends of 4 per cent. for two successive years on the first preferred stock, to convert the second preferred stock not exceeding \$42,000,000, par value, one-half into first preferred stock, and one-half into common stock, and to increase its first preferred and common stock to the extent necessary to effect such conversion. The company never exercised the right to convert or redeem the preferred stock.

It will be observed that the preferred stock and the common stock with 1,400,000 shares of each were thus

given an equality of voting power which could not be changed without the consent of the company, and that it has not been changed either by conversion or redemption. This would seem to have been designed to preserve an equilibrium of control in which reasonable dividends out of profits when they accrued in sufficient amount would be voted to the common stockholders on the one hand, and proper additions would be made out of earnings to the capital of the company to increase its future profit-earning capacity and create a greater security for a constant payment of dividends to preferred stockholders. Of course there would not be block voting of the two classes of stock but the division did tend to secure a fair representation of both interests in the board of directors.

The effect of the agreement as to dividends upon the preferred and common stock seems to us clear. It emphasizes that dividends are to be paid only out of undivided profits and when and as determined by the board of directors and only if and when the board shall declare them. It leaves to the board to determine in its discretion whether the undivided profits shall be put in surplus working capital or in dividends. The limitations on the discretion of the board are that the first and second preferred can not receive more than four per cent. in any fiscal year, and that neither the second preferred nor the common stock can receive any dividend until the first preferred dividend has been paid in full each year and the common stock receives nothing until the second preferred dividend is thus paid. The words describing the condition upon which the power of the board to declare dividends on the common stock can be exercised, show that each year's profits are to be considered by themselves in the distribution of dividends between the stock.

Appellants, however, rely on the final words of the clause to show that it is intended that net profits in any past year can be thereafter allowed to the common stock

if in that past year the preferred stock had been paid full dividends. We do not find it necessary to decide that the board of directors has not such power; but if so, the power is not one the exercise of which can be compelled in the absence of fraud or breach of trust. The failure of the board to exercise it, and the application of the earnings to surplus determine such earnings to be assets as of the time of the compulsory winding up and liquidation of the corporation. The power to declare dividends not exercised can have no more effect upon the rights of the preferred stockholders to share in the existing assets of the corporation when liquidated than the failure of the company to convert preferred stock into common, or to redeem the preferred stock at par. The proper interpretation of the agreement is that, after the declaration of dividends for any current year, the undivided earnings are to be regarded as capital assets and to be distributed on liquidation, unless the board of directors has meantime applied them as dividends. If the argument of appellants were carried to its logical result, all the net earnings of the Reading Company in twenty-five years no matter how invested or applied to increasing the earning capital, must in a liquidation be treated as undistributed profits to go entirely to the common stock without any action of the board of directors. This is impossible.

The record discloses that in 1904, when the Reading Company made its application to the New York Stock Exchange to have its stock listed, it contained the following statement:

"The Preferred and Common stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets."

Coming as this must have come from the representatives of both the preferred and common stockholders, it is significant evidence of what they then thought of their

respective rights and has the additional weight of a representation to future purchasers of the two classes of stock as to the kind of interests they were buying in the company.

Our conclusion that the claim on behalf of the common stockholders is invalid is based on the construction of the words of the agreement itself and hardly needs authority to sustain it. It is, however, in accord with the general common-law rule that stockholders common and preferred share alike in the assets of a liquidating corporation, if the preference is only as to dividends. *Hamlin v. Toledo, St. L. & K. C. R. R. Co.*, 78 Fed. 664, 672, opinion by Mr. Justice Lurton, then Circuit Judge; *Toledo, St. L. & K. C. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 531; *Guaranty Trust Co. v. Galveston City R. R. Co.*, 107 Fed. 311, 318; *Birch v. Cropper*, L. R. 39 Ch. D. 1; 14 App. Cas. 525; *In re Accrington Corporation Steam Tramways Co.* [1909], 2 Ch. 40; *Lloyd v. Pennsylvania Electric Vehicle Co.*, 75 N. J. Eq. 263; *Jones v. Concord & Montreal R. R. Co.*, 67 N. H. 119, 234; *Drewry Hughes Co. v. Throckmorton*, 120 Va. 859. This is the rule in Pennsylvania. *North American Mining Co. v. Clarke*, 40 Pa. St. 432. The cases in which a different conclusion has been reached are where the contract or law determining the rights of the preferred stockholders has an express or clearly implied restriction as to the share which they may take in the assets on liquidation. *Niles v. Ludlow Valve Mfg. Co.*, 196 Fed. 994; *Russell v. American Gas Co.*, 152 App. Div. 136.

Counsel for one of the appellants has called attention to the fact, not appearing in any assignment of error, that among the assets of the old Reading Company which the new Reading Company will continue to hold is one million dollars par value and of much greater actual value in the stock of the Reading Iron Company, an iron manufacturing company, and that under the constitution of Penn-

sylvania it will be unlawful for the new Reading Company as a railroad company to continue to own it. Questions as to the propriety and legality of this holding of the old Reading Company did not arise when the case was before this court originally and do not arise on the record before us now in any such way as to enable us to say whether the federal commodities clause or the constitution of Pennsylvania will thus be violated in carrying out the plan by which the Reading Company is to become a railroad company. This must be determined by the District Court in further hearings and consideration at the time the final decree comes to be settled in accordance with our mandate, when it will have authority to modify the plan in this respect to satisfy the requirements of law.

The decree of the District Court is affirmed with modifications already indicated and the case is remanded for further proceedings in conformity to this opinion

Affirmed with modifications.

MR. JUSTICE BRANDEIS took no part in the consideration or decision of this case.